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THE GENERAL STATUTES OF NORTH CAROLINA

ANNOTATED

1997 CUMULATIVE SUPPLEMENT

Volume 6

Chapters 21 through 27

Prepared under the supervision of

The Department of Justice
of the State of North Carolina

BY

The Editorial Staff of the Publishers

Under the Direction of

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Annotated through 486 S.E.2d 626. For complete scope of annotations, see scope of volume page.

**Place Behind Supplement Tab in Binder Volume.
This Supersedes Previous Supplement, Which
May Be Retained for Reference Purposes.**

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Preface

This Cumulative Supplement to Volume 6 contains the general laws of a permanent nature enacted by the General Assembly through the 1997 Regular Session, which are within the scope of such volume, and brings to date the annotations included therein.

Amendments are inserted under the same section numbers appearing in the General Statutes, and new laws appear under the proper chapter headings.

Chapter analyses show all affected sections, except sections for which catchlines are carried for the purpose of notes only. An index to all statutes codified herein will appear in the Replacement Index Volumes.

A majority of the Session Laws are made effective upon ratification, but a few provide for stated effective dates. If the Session Law makes no provision for an effective date, the law becomes effective under G.S. 120-20 "from and after 30 days after the adjournment of the session" in which passed.

Beginning with the opinions issued by the North Carolina Attorney General on July 1, 1969, any opinion which construes a specific statute is cited as an annotation to that statute. For a copy of an opinion or of its headnotes write the Attorney General, P.O. Box 629, Raleigh, N.C. 27602.

The members of the North Carolina Bar are requested to communicate any defects they may find in the General Statutes or in this Cumulative Supplement and any suggestions they may have for improving the General Statutes, to the Department of Justice of the State of North Carolina, or to Michie, Law Publishers, Charlottesville, Virginia.

User's Guide

In order to assist both the legal profession and the layperson in obtaining the maximum benefit from the North Carolina General Statutes, a User's Guide has been included in Volume 1. This guide contains comments and information on the many features found within the General Statutes intended to increase the usefulness of this set of laws to the user. See the main volume for the complete User's Guide.

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Scope of Volume

Statutes:

Permanent portions of the General Laws enacted by the General Assembly through the 1997 Regular Session affecting Chapters 21 through 27 of the General Statutes.

Annotations:

Sources of the annotations to the General Statutes appearing in this volume are:

North Carolina Reports through Volume 344, p. 732.
North Carolina Court of Appeals Reports through Volume 123, p. 790.
South Eastern Reporter 2nd Series through Volume 486, p. 626.
Federal Reporter 3rd Series through Volume 116, p. 875.
Federal Supplement through Volume 965, p. 1486.
Federal Rules Decisions through Volume 172, p. 600.
Bankruptcy Reports through Volume 209, p. 549.
Supreme Court Reporter through Volume 117, p. 1864.
North Carolina Law Review through Volume 75, p. 1088.
Wake Forest Law Review through Volume 32, p. 217.
Campbell Law Review through Volume 18, p. 201.
Duke Law Journal through Volume 45, p. 1088.
North Carolina Central Law Journal through Volume 25, p. 100.
Opinions of the Attorney General.

The General Statutes of North Carolina
1997 Cumulative Supplement

VOLUME 6

Chapter 22.

Contracts Requiring Writing.

Sec.
22-3. [Repealed.]
22-5. Commercial loan commitments.

§ 22-1. Contracts charging representative personally; promise to answer for debt of another.

CASE NOTES

I. In General.
III. Promise to Answer for Debt of Another.
  B. Illustrative Cases.

I. IN GENERAL.

Contracts for Services. — There is no requirement in this State that contracts for services not to be performed within a year be in writing and signed by the party to be charged therewith. Messer v. Laurel Hill Assocs., 93 N.C. App. 439, 378 S.E.2d 220 (1989).

Cited in Forbes Homes, Inc. v. Trimpi, 318 N.C. 473, 349 S.E.2d 852 (1986).

III. PROMISE TO ANSWER FOR DEBT OF ANOTHER.

B. Illustrative Cases.

A promise to pay a decedent's debts must be in writing when such debts are generally charged to the decedent's estate. Parrish Funeral Home v. Pittman, 104 N.C. App. 268, 409 S.E.2d 327 (1991).

Promise to Pay Funeral Expenses. — Defendant's alleged promise to pay funeral expenses for his deceased father if the estate did not was a promise to pay the debt of another, which is void by law unless in writing. Parrish Funeral Home v. Pittman, 104 N.C. App. 268, 409 S.E.2d 327 (1991), holding, however, that as defendants did not specifically plead the statute of frauds, it was not available as a defense.

Testimony of Promise to Pay Former Wife's Debt to Plaintiff Allowed. — Trial court did not err in allowing testimony of oral communications concerning defendant's promise to pay former wife's debt to plaintiff; defendant's promise constituted an original promise, and therefore was not subject to the writing requirement where defendant promised plaintiff that he would make all of the monthly payments on the mortgage note; furthermore, he made the agreement directly with plaintiff, rather than solely with former wife to pay off her debt to her mother, and defendant's promise to plaintiff was supported by independent consideration; namely, plaintiff pledged her own residence as collateral and obtained for defendant a $25,000 loan. Effler v. Pyles, 94 N.C. App. 349, 380 S.E.2d 149 (1989).

§ 22-2. Contract for sale of land; leases.

Legal Periodicals. —

For note on waiver of closing date in land sales contracts in North Carolina, in light of Fletcher v. Jones, 314 N.C. 389, 333 S.E.2d 731 (1985), see 8 Campbell L. Rev. 546 (1986).

For article, "Private Land Use Controls: Enforcement Problems with Real Covenants and Equitable Servitudes in North Carolina," see 22 Wake Forest L. Rev. 749 (1987).

CASE NOTES

I. In General.
II. What Constitutes an Interest in or Concerning Land.
III. Sufficiency of Compliance with Section.
  A. In General.

I. IN GENERAL.

Applicable to Lease Greater than Three Years. — Where alleged lease was for a term greater than three years this section was applicable. Computer Decisions, Inc. v. Rouse Office Mgt. of N.C., Inc., 124 N.C. App. 383, 477 S.E.2d 262 (1996).

Parol assurances made by a developer to prospective buyers regarding the general scheme or plans of development that the developer intends to pursue are admissible to establish the existence of such a scheme. Such parol evidence may be in the form of a field map, sales brochures, maps, advertising or oral statements on which purchasers relied. River Birch Assocs. v. City of Raleigh, 326 N.C. 100, 388 S.E.2d 538 (1990).

Use of parole evidence to determine area referred to in declaration of covenants. — In determining whether subdivision common area included a certain three-acre parcel, the trial court improperly excluded evidence of statements made by agents to buyers, and should have admitted preliminary plat and landscaping plan as maps tending to identify the common area referred to in the declaration of covenants. River Birch Assocs. v. City of Raleigh, 326 N.C. 100, 388 S.E.2d 538 (1990).

Applied in Britt v. Britt, 320 N.C. 573, 359 S.E.2d 467 (1987); Schafer v. Barrier Island Station, Inc., 946 F.2d 1075 (4th Cir. 1991).

Cited in Sprouse v. North River Ins. Co., 81 N.C. App. 311, 344 S.E.2d 555 (1986); Brooks v. Hackney, 329 N.C. 166, 404 S.E.2d 854 (1991).

II. WHAT CONSTITUTES AN INTEREST IN OR CONCERNING LAND.

Parol Agreement as to Division of Profits, etc. —

The statute of frauds does not apply where a party seeks to prove an oral agreement with respect to the disposition of proceeds from a sale of land, rather than to force or prevent conveyance of the land itself. Rongotes v. Pridemore, 88 N.C. App. 363, 363 S.E.2d 221 (1988).

III. SUFFICIENCY OF COMPLIANCE WITH SECTION.

A. In General.

It is Not Necessary, etc. —

The statute of frauds does not require all the provisions of the contract to be set out in a single instrument. The memorandum required by the statute is sufficient if the contract provisions can be determined from separate but related writings. Rose v. Lang, 85 N.C. App. 690, 355 S.E.2d 795 (1987).

Writing Must Describe Subject Matter. —

A deed or contract to sell land must contain, among other things, sufficient description of land to be sold or conveyed, to satisfy statute of frauds. To be sufficient, description must be certain in itself or capable of being reduced to certainty by reference to something extrinsic to which contract refers. Brooks v. Hackney, 100 N.C. App. 562, 397 S.E.2d 361 (1990), rev'd on other grounds, 329 N.C. 166, 404 S.E.2d 854 (1991).

Property descriptions that purport to carve small tracts of land out

of larger tracts must specifically identify part to be conveyed in order to comply with statute of frauds. Brooks v. Hackney, 100 N.C. App. 562, 397 S.E.2d 361 (1990), rev'd on other grounds, 329 N.C. 166, 404 S.E.2d 854 (1991).

When Patent Ambiguity Exists. — Patent ambiguity is such an uncertainty appearing on face of instrument that a court, reading language in light of all facts and circumstances referred to in instrument, is unable to derive therefrom intention of the parties as to what land was to be conveyed. Brooks v. Hackney, 100 N.C. App. 562, 397 S.E.2d 361 (1990), rev'd on other grounds, 329 N.C. 166, 404 S.E.2d 854 (1991).

Whether Ambiguity Is Patent or Latent Is Question of Law. — Where ambiguity exists in a property description contained in writing, it is question of law to be decided by court as to whether ambiguity is patent or latent. Brooks v. Hackney, 100 N.C. App. 562, 397 S.E.2d 361 (1990), rev'd on other grounds, 329 N.C. 166, 404 S.E.2d 854 (1991).

Patent Ambiguity Precludes Use of Parol Evidence. — Parol evidence is not admitted to explain patent ambiguities. Brooks v. Hackney, 100 N.C. App. 562, 397 S.E.2d 361 (1990), rev'd on other grounds, 329 N.C. 166, 404 S.E.2d 854 (1991).

Vague and Indefinite Description of Land Void. — If description of land is so vague and indefinite that effect cannot be given instrument without writing new, material language into it, then it is void and ineffectual. Brooks v. Hackney, 100 N.C. App. 562, 397 S.E.2d 361 (1990), rev'd on other grounds, 329 N.C. 166, 404 S.E.2d 854 (1991).

Writing did not sufficiently describe particular twenty-five acre portion of tract because northern boundary, described as "with the Whitehead line. Thence straight to road that goes by Plainfield Church ..." could have been drawn in infinite number of ways. Accordingly, as a matter of law, the contract was void under statute of frauds and not enforceable. Brooks v. Hackney, 100 N.C. App. 562, 397 S.E.2d 361 (1990), rev'd on other grounds, 329 N.C. 166, 404 S.E.2d 854 (1991).

§ 22-3: Repealed by Session Laws 1995, c. 379, s. 15, effective July 6, 1995.

§ 22-5. Commercial loan commitments.

No commercial loan commitment by a bank, savings and loan association, or credit union for a loan in excess of fifty thousand dollars ($50,000) shall be binding unless the commitment is in writing and signed by the party to be bound. As used in this section, the term "commercial loan commitment" means an offer, agreement, commitment, or contract to extend credit primarily for business or commercial purposes and does not include charge or credit card accounts, personal lines of credit, overdrafts, or any other consumer account. Offers, agreements, commitments, or contracts to extend credit primarily for aquaculture, agricultural, or farming purposes are specifically exempted from the provisions of this section. (1989, c. 678.)

Editor's Note. — Session Laws 1989, c. 678, s. 2, made this section effective on October 1, 1989, and applicable to commercial loan commitments entered into on or after that date.

Chapter 22A.

Signatures.

Sec.
22A-1. Use of a signature facsimile by a handicapped person.

§ 22A-1. Use of a signature facsimile by a handicapped person.

A handicapped person, as defined in G.S. 168A-3(4), may use a registered signature facsimile as a proper mark of the person's legal signature. An example of the signature facsimile shall be registered by the handicapped person with the clerk of the superior court in the county where the person lives. The registered signature facsimile may be revoked at any time in writing by the handicapped person. (1973, c. 878; 1997-208, s. 1.)

Effect of Amendments. — The 1997 amendment, effective June 19, 1997, deleted "visually" preceding "handicapped" in the catchline and throughout the section; in the first sentence substituted "G.S. 168A-3(4)" for "G.S. 111-11"; and at the end of the second sentence substituted "where the person's lives" for "of his domicile."

Chapter 22C.

Payments to Subcontractors.

Sec.
22C-2. Performance by subcontractor.

§ 22C-2. Performance by subcontractor.

Performance by a subcontractor in accordance with the provisions of its contract shall entitle it to payment from the party with whom it contracts. Payment by the owner to a contractor is not a condition precedent for payment to a subcontractor and payment by a contractor to a subcontractor is not a condition precedent for payment to any other subcontractor, and an agreement to the contrary is unenforceable. (1987 (Reg. Sess., 1988), c. 946, s. 1; 1991, c. 620, s. 1.)

Editor's Note. — Session Laws 1991, c. 620, s. 1, amended this section effective July 9, 1991, and applied to those contracts entered into on or after July 9, 1991.

CASE NOTES

Timing of Payment to Subcontractor. — Section 22C-3 addresses only the issue of what is to be done when the general contractor has already been paid, but says nothing about what happens when the owner does not pay; in effect, it sets an outer boundary for payment to the subcontractor of seven days after the general contractor has been paid, but it does not eliminate the possibility that the subcontractor may be entitled to payment earlier than that. If the legislature had intended to overturn the rule established by Howard-Green Elec. Co. v. Chaney & James Constr. Co., 12 N.C. App. 63, 182 S.E.2d 601 (1971), it would have done so in unmistakable language. Statesville Roofing & Heating Co. v. Duncan, 702 F. Supp. 118 (W.D.N.C. 1988).

§ 22C-3. Time of payment to subcontractors after contractor or other subcontractor has been paid.

CASE NOTES

This section addresses only the issue of what is to be done when the general contractor has already been paid, but says nothing about what happens when the owner does not pay; in effect, it sets an outer boundary for payment to the subcontractor of seven days after the general contractor has been paid, but it does not eliminate the possibility that the subcontractor may be entitled to payment earlier than that. If the legislature had intended to overturn the rule established by Howard-Green Elec. Co. v. Chaney & James Constr. Co., 12 N.C. App. 63, 182 S.E.2d 601 (1971), it would have so in unmistakable language. Statesville Roofing & Heating Co. v. Duncan, 702 F. Supp. 118 (W.D.N.C. 1988).

Chapter 23.

Debtor and Creditor.

Article 1.

Assignments for Benefit of Creditors.

Sec.
23-9. Creditors to file verified claims with clerk; false swearing misdemeanor.
23-12. Trustee violating duties guilty of misdemeanor.

Article 5.

General Provisions under Articles 2, 3, and 4.

23-43. False swearing; penalty.

Sec.

Article 6.

Practice in Insolvency and Certain Other Proceedings.

23-47. Violation of preceding section a misdemeanor.

ARTICLE 1.

Assignments for Benefit of Creditors.

§ 23-9. Creditors to file verified claims with clerk; false swearing misdemeanor.

All creditors of the maker of such deed of trust shall, before receiving payment of any amount from the said trustee, file with the clerk of the superior court a statement under oath that the amount claimed by him is justly due, after allowing all credits and offsets, to the best of his knowledge and belief. Any creditor who shall knowingly swear falsely in such statement shall be guilty of a Class 1 misdemeanor. (1893, c. 453, ss. 6, 7; Rev., ss. 972, 3617; C.S., s. 1617; 1993, c. 539, s. 397; 1994, Ex. Sess., c. 14, s. 34; c. 24, s. 14(c).)

Editor's Note. — Session Laws 1993, c. 539, s. 397, which amended this section, in s. 1359, as amended by Session Laws 1994, Extra Session, c. 24, s. 14(c), provides: "This act becomes effective October 1, 1994, and applies to offenses occurring on or after that date. Prosecutions for offenses committed before the effective date of this act are not abated or affected by this act, and the statutes that would be applicable but for this act remain applicable to those prosecutions."

Session Laws 1994, Extra Session, c. 14, s. 73 provides: "Prosecutions for offenses committed before the effective date of this act [October 1, 1994] are not abated or affected by this act, and the statutes that would be applicable but for this act remain applicable to those prosecutions."

Session Laws 1994, c. 14, s. 34, and c. 24, s. 14(c), which amended this section, were Extra Session amendment, effective on the same date that Chapter 539 of the 1993 Session Laws became effective (October 1, 1994), and applicable to offenses occurring on or after that date.

§ 23-12. Trustee violating duties guilty of misdemeanor.

If any trustee in a deed of trust for the benefit of creditors shall fail to file his inventory as required by law, or shall knowingly make any false statement in such inventory, or shall knowingly fail to include any property therein, or shall sell any part of the property described in the deed of trust within ten days unless such property so sold be perishable, or shall fail to file either of the quarterly accounts or the final accounts as required by law, or shall knowingly make any false statement in such quarterly or final account, or shall knowingly fail to include any property, money or disbursement in such quarterly or final account, he shall, in either case, be guilty of a Class 1 misdemeanor. (1893, c. 453, s. 8; Rev., s. 3689; C.S., s. 1620; 1993, c. 539, s. 398; 1994, Ex. Sess., c. 24, s. 14(c).)

Editor's Note. — Session Laws 1993, c. 539, s. 398, which amended this section, in s. 1359, as amended by Session Laws 1994, Extra Session, c. 24, s. 14(c), provides: "This act becomes effective October 1, 1994, and applies to offenses occurring on or after that date. Prosecutions for offenses committed before the effective date of this act are not abated or affected by this act, and the statutes that would be applicable but for this act remain applicable to those prosecutions."

ARTICLE 5.

General Provisions under Articles 2, 3, and 4.

§ 23-43. False swearing; penalty.

If any insolvent or imprisoned debtor takes any oath prescribed in this chapter falsely and corruptly, that person is guilty of a Class I felony, and he shall never after have any of the benefits of this chapter, but may be sued and imprisoned as though he had never been discharged. (1793, c. 100, s. 10, P.R.; R.C., c. 59, s. 25; 1868-9, c. 162, s. 23; Code, s. 2964; Rev., ss. 1940, 3614; C.S., s. 1651; 1993, c. 539, s. 1263; 1994, Ex. Sess., c. 24, s. 14(c).)

Editor's Note. — Session Laws 1993, c. 539, s. 1263, which amended this section, in s. 1359, as amended by Session Laws 1994, Extra Session, c. 24, s. 14(c), provides: "This act becomes effective October 1, 1994, and applies to offenses occurring on or after that date. Prosecutions for offenses committed before the effective date of this act are not abated or affected by this act, and the statutes that would be applicable but for this act remain applicable to those prosecutions."

ARTICLE 6.

Practice in Insolvency and Certain Other Proceedings.

§ 23-47. Violation of preceding section a misdemeanor.

Any individual, corporation, or firm or other association of persons violating any provision of G.S. 23-46 shall be guilty of a Class 1 misdemeanor. (1931, c. 208, s. 3; 1993, c. 539, s. 399; 1994, Ex. Sess., c. 24, s. 14(c).)

Editor's Note. — Session Laws 1993, c. 539, s. 399, which amended this section, in s. 1359, as amended by Session Laws 1994, Extra Session, c. 24, s. 14(c), provides: "This act becomes effective October 1, 1994, and applies to offenses occurring on or after that date. Prosecutions for offenses committed before the effective date of this act are not abated or affected by this act, and the statutes that would be applicable but for this act remain applicable to those prosecutions."

Chapter 24.

Interest.

Article 1.

General Provisions.

Sec.
24-2.3. State opt-out from federal preemption.
24-8. Loans not in excess of $300,000; what interest, fees and charges permitted.
24-9. Loans to certain entities organized for profit not subject to claim or defense of usury.
24-9.2. [Repealed.]
24-9.3. Economic development loans.
24-10.1. Late fees.
24-11. Certain revolving credit charges.

Article 2.

Loans Secured by Secondary or Junior Mortgages.

Sec.
24-14. Limitations on charges and interest.
24-17. Misdemeanors.

ARTICLE 1.

General Provisions.

§ 24-1. Legal rate is eight percent.

CASE NOTES

Unless Defendant Agreed to Rate Set Pay Court. —. Where defendant agreed to let the trial court set the rate of interest, he could not on appeal argue that the trial court lacked authority to set the interest rate above the legal rate. Coston v. Coston, 109 N.C. App. 306, 426 S.E.2d 460 (1993).

For the last three words of this section to be of any significance, it must necessarily be inferred that interest may be imposed on judgments at a rate less than 8% if requested by the party entitled to the interest. Where a plaintiff's attorney prepared a 1980 judgment asking for 6%, court would presume that is what he intended. Speros Constr. Co. v. Musselwhite, 103 N.C. App. 510, 405 S.E.2d 785 (1991).

Fraudulent Procurement of Money. — No implied contract resulted from a defendant's act of fraudulently obtaining the money from a plaintiff or from a court's order that the defendant pay restitution to the plaintiff, because there was no meeting of the minds between the parties. The law in effect at the time of an agreement determines the rate of interest on an obligation only where an agreement has actually been reached. Otherwise, the law in effect at the time of judgment determines the rate of interest. Speros Constr. Co. v. Musselwhite, 103 N.C. App. 510, 405 S.E.2d 785 (1991).

Where a plaintiff brought an action to prevent the 10-year statute of limitations from barring his recovery on a prior judgment, the action was in the nature of an independent action on the judgment, the only procedure in this state by which a judgment can be renewed. As it was a separate and distinct action, the plaintiff could request, in his complaint, interest at the legal rate of 8%, and the trial court could award interest at that rate from the date the present action was instituted until the judgment is satisfied. Speros Constr. Co. v. Musselwhite, 103 N.C. App. 510, 405 S.E.2d 785 (1991).

Applied in Leggett v. Rose, 776 F. Supp. 229 (E.D.N.C. 1991); Jacobs v. Central Transp., Inc., 891 F. Supp. 1120 (E.D.N.C. 1995).

Cited in Borg-Warner Acceptance Corp. v. Johnston, 107 N.C. App. 174, 419 S.E.2d 195 (1992), cert. denied, 333 N.C. 254, 424 S.E.2d 918 (1993); Knight Publishing Co. v. Chase Manhattan Bank, 125 N.C. App. 1, 479 S.E.2d 478 (1997).

§ 24-1.1. Contract rates and fees.

CASE NOTES

Section 25-9-203 does not make an Article 9 transaction subject to this Section. Borg-Warner Acceptance Corp. v. Johnston, 107 N.C. App. 174, 419 S.E.2d 195 (1992), cert. denied, 333 N.C. 254, 424 S.E.2d 918 (1993).

Fraudulent Procurement of Money. — No implied contract resulted from a defendant's act of fraudulently obtaining the money from a plaintiff or from a court's order that the defendant pay restitution to the plaintiff, because there was no meeting of the minds between the parties. The law in effect at the time of an agreement determines the rate of interest on an obligation only where an agreement has actually been reached. Otherwise, the law in effect at the time of judgment determines the rate of interest. Speros Constr. Co. v. Musselwhite, 103 N.C. App. 510, 405 S.E.2d 785 (1991).

Stated in West Raleigh Group v. Massachusetts Mut. Life Ins. Co., 809 F. Supp. 384 (E.D.N.C. 1992).

Cited in Hatcher v. Rose, 329 N.C. 626, 407 S.E.2d 172 (1991).

§ 24-1.1A. Contract rates on home loans secured by first mortgages or first deeds of trust.

CASE NOTES

Prepayment Allowed Prior to Enactment of § 24-2.4. — Considering the acts of the General Assembly, specifically § 24-10 and this section, the law of North Carolina prior to the enactment of § 24-2.4 was that the mortgagor had the right of prepayment when the note was silent. Hatcher v. Rose, 329 N.C. 626, 407 S.E.2d 172 (1991).

Stated in West Raleigh Group v. Massachusetts Mut. Life Ins. Co., 809 F. Supp. 384 (E.D.N.C. 1992).

Cited in Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

§ 24-2. Penalty for usury; corporate bonds may be sold below par.

Legal Periodicals. —

For survey on usury law, see 70 N.C.L. Rev. 1983 (1992).

CASE NOTES

I. General Consideration.
IV. Rights of Subsequent Purchasers.
VI. Pleading and Practice.

I. GENERAL CONSIDERATION.

But Payment Is Necessary for Recovery. —

To be entitled to recover this penalty for usury, plaintiff must have been charged usurious interest and must have actually paid the usurious interest. Adams v. Beard Dev. Corp., 116 N.C. App. 105, 446 S.E.2d 862 (1994).

Double Damages Proper. — Plaintiff was properly awarded $1,700 in damages for usury, and was entitled to have the damages doubled pursuant to this section. Britt v. Jones, 123 N.C. App. 108, 472 S.E.2d 199 (1996).

The charging which constitutes a forfeiture is the contract, promise or

agreement to a usurious rate of interest as opposed to the actual payment of that interest. Haanebrink v. Meyer, 47 N.C. App. 646, 267 S.E.2d 598 (1980); Northwestern Bank v. Barber, 79 N.C. App. 425, 339 S.E.2d 452 (1986); Adams v. Beard Dev. Corp., 116 N.C. App. 105, 446 S.E.2d 862 (1994).

Late Payment Fees Are "Interest". — The General Assembly, which specified a maximum legal rate for late payment fees in § 24-10.1, considered such fees "interest" and intended to induce observance of that law through the penalty provisions of this section. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

Penalty fees for late payments are "interest" and are compensation for the detention of money owed another, and all such compensation must be forfeited when its rate is usurious, as defined by the laws of this state. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

This Section Applicable to Enforce Violations of § 24-10.1. — The statutory penalty for usury requires a defendant which has charged late payments in excess of the legal maximum rate permitted by former § 24-10(e) (see now § 24-10.1) to forfeit all late payment charges to which it might otherwise have been entitled under the terms of the loan, but defendant is not required to forfeit the interest due on the loan itself. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

Cited in Borg-Warner Acceptance Corp. v. Johnston, 107 N.C. App. 174, 419 S.E.2d 195 (1992).

IV. RIGHTS OF SUBSEQUENT PURCHASERS.

Rule Applies to Obligations Secured by Mortgages. — The only case that seems to mitigate against the otherwise uniform tenor of the decisions on this subject is Coor v. Spicer, 65 N.C. 401 (1871), which holds that a mortgage given to secure a usurious bond might be enforced in the hands of an innocent purchaser for value. The case recognizes the general rule, but takes mortgages out of it upon the supposed wording of former § 39-20. Aside from the fact that this is held expressly otherwise in the later case of Moore v. Woodward, 83 N.C. 531 (1880), an examination of former § 39-20 will show that Coor v. Spicer was a palpable inadvertence. That statute in fact does not purport to protect the innocent holder of a mortgage note which is tainted with usury but the "purchaser of the estate or property" at sale under the mortgage, who buys without notice of the usurious taint in the debt secured. It would be a fraud for the mortgagor to stand by and let him purchase without giving him notice, but the make can give no notice usually to the assignee of the note. Ward v. Sugg, 113 N.C. 489, 18 S.E. 717 (1893).

VI. PLEADING AND PRACTICE.

Statute of Limitations. —

Where plaintiff filed his complaint seeking forfeiture of all interest more than two years after the execution of promissory note, the two-year statute of limitations barred plaintiff's claim for forfeiture of interest pursuant to this section. Adams v. Beard Dev. Corp., 116 N.C. App. 105, 446 S.E.2d 862 (1994).

§ 24-2.1. Transactions governed by Chapter.

CASE NOTES

Chapter Places Burden of Expertise on Lender. — The usury statutes relieve the borrower of the necessity for expertise and vigilance regarding the legality of rates he must pay. That onus is placed instead on the lender, whose business it is to lend money for profit and who is thus in a better position than the borrower to know the law. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

"Usury Savings Clause". — A lender cannot charge usurious rates with impunity via a "usury savings clause," by making that rate conditional upon its legality and relying upon the illegal rate's automatic rescission when discovered and challenged by the borrower. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

§ 24-2.3. State opt-out from federal preemption.

(a) The provisions of section 501, of United States Public Law 96-221, as well as any modifications made to date, shall not apply to loans, mortgages, credit sales and advances made in this State.

(b) Effective July 1, 1995, sections 521-524 of United States Public Law 96-221, shall apply to loans, mortgages, credit sales, and advances made in this State on or after that date as if North Carolina had never opted out of sections 521-524 of United States Public Law 96-221. (1983, c. 126, s. 1; 1995, c. 387, s. 1.)

§ 24-2.4. Prepayment of a loan if there are no prepayment terms or if the prepayment terms are not in accordance with law.

CASE NOTES

Prepayment Allowed Prior to Enactment of this Section. — Considering the acts of the General Assembly, specifically §§ 24-10 and 24-1.1A, the law of North Carolina prior to the enactment of this section was that the mortgagor had the right of prepayment when the note was silent. Hatcher v. Rose, 329 N.C. 626, 407 S.E.2d 172 (1991).

Prepayment was allowed on a promissory note executed before the enactment of this section, and for the purchase of real estate even though the note did not by specific language either prohibit or permit prepayment. Hatcher v. Rose, 329 N.C. 626, 407 S.E.2d 172 (1991).

Cited in In re Carr Mill Mall Ltd. Partnership, 201 Bankr. 415 (Bankr. M.D.N.C. 1996).

§ 24-5. (See editor's note) Contracts, except penal bonds, and judgments to bear interest.

Editor's Note. —

Important — Please Read. — *In 1995, the North Carolina Supreme Court held in Custom Molders, Inc. v. American Yard Products, Inc., 342 N.C. 133, 463 S.E.2d 199 (1995), that an applications provision in the 1985 session law rewriting this section had the effect of continuing a sentence from the pre-1981 version of subsection (b) that allowed for postjudgment interest on noncontract awards generally, although the General Assembly failed to include the sentence in the 1985 revision. According to the court, the following sentence is still part of the section: "In like manner, the amount of any judgment or decree, except the costs, rendered or adjudged in any kind of action, though not on contract, shall bear interest till paid, and the judgment and decree of the court shall be rendered according to this section."*

Legal Periodicals. — For note, "Baxley v. Nationwide Mutual Insurance Company: A Key Loophole in the Financial Responsibility Act of 1953 Comes to Light," see 72 N.C.L. Rev. 1809 (1994).

CASE NOTES

I. In General.
II. Contracts.
III. Other Actions.
IV. Prejudgment Interest.

I. IN GENERAL.

Purpose of 1985 Amendment. — When the legislature amended subsection (a) in 1985 to provide that the amount awarded on contract bears interest from date of breach it obviated the need for the rule that when the amount of damages in a breach of contract action is ascertained from contract itself, relevant evidence, or both, interest should be allowed from the date of breach. Metromont Materials Corp. v. R.B.R. & S.T., 120 N.C. App. 616, 463 S.E.2d 305 (1995).

This section is not a part of the Financial Responsibility Act; therefore, its provisions need not be written into every automobile liability insurance policy. Sproles v. Greene, 329 N.C. 603, 407 S.E.2d 497 (1991).

Postjudgment Interest on Treble Damages. — This section provides for postjudgment interest on judgments for money damages generally, including a judgment for treble damages, until the judgment is paid. Custom Molders, Inc. v. American Yard Prods., Inc., 342 N.C. 133, 463 S.E.2d 199 (1995).

Unconditional Payment Offers. — An aggrieved party may, without prejudice to its right to recover prejudgment interest, decline unconditional payment offers. Members Interior Constr., Inc. v. Leader Constr. Co., 124 N.C. App. 121, 476 S.E.2d 399 (1996).

Nothing in this section precludes the award of interest damages when those damages are recoverable under ordinary damage principles as a natural and foreseeable consequence of wrongdoing or damages within the contemplation of the parties as a probable result of their wrongdoing. Broussad v. Meineke Discount Muffler Shops, Inc., W.D.N.C., 958 F. Supp 1087 (1997).

There is no indication that this section is designed to cap or otherwise diminish damages based on lost interest where those damages are recoverable under ordinary damage principles. Broussad v. Meineke Discount Muffler Shops, Inc., W.D.N.C., 958 F. Supp 1087 (1997).

II. CONTRACTS.

Interest Allowed from Date of Breach. —

This section authorizes interest on damages resulting from breach of contract from the date of the breach at the rate of interest provided in the contract or at the legal rate if no other rate is provided; the legal rate of interest on judgments in North Carolina is eight percent (8%) per year. Jacobs v. Central Transp., Inc., 891 F. Supp. 1120 (E.D.N.C. 1995).

Where plaintiff's claims for damages and the trial judge's subsequent order were grounded in the equitable principles of restitution or quasi-contract as opposed to the legal principles of contract law, interest was properly assessed from the date of the breach of contract. Farmah v. Farmah, — N.C. App. —, 484 S.E.2d 96 (1997).

III. OTHER ACTIONS.

It Is Discretionary with Jury, etc. —

Under law the jury has discretion to award prejudgment interest in tort cases involving property losses. Leggett v. Rose, 776 F. Supp. 229 (E.D.N.C. 1991).

Where a plaintiff brought an action to prevent the 10-year statute of limitations from barring his recovery on a prior judgment, the action was in the nature of an independent action on the judgment, the only procedure in this state by which a judgment can be renewed. As it was a separate and distinct action, the plaintiff could request, in his complaint, interest at the legal rate of eight percent, and the trial court could award interest at that rate from the date the present action was instituted until the judgment is satisfied. Speros Constr. Co. v. Musselwhite, 103 N.C. App. 510, 405 S.E.2d 785 (1991).

Under North Carolina law, interest runs from the date of the defendant's breach, not the date of the plaintiff's demand for a refund. Canady v. Crestar Mtg. Corp., 109 F.3d 969 (4th Cir. 1997).

District court erred in holding that interest would not run until date that plaintiff's demanded refund. Canady v. Crestar Mtg. Corp., 109 F.3d 969 (4th Cir. 1997).

IV. PREJUDGMENT INTEREST.

Applicability of Subsection (b). — No award of prejudgment interest, because subsection (b) is inapplicable, since a final judgment, including a judgment as to liability, had not been entered. Collins v. Beck, 116 N.C. App. 128, 446 S.E.2d 610, aff'd, 340 N.C. 255, 456 S.E.2d 307 (1995).

Prejudgment Interest Held Not a Cost Within Meaning of Policy. — Where insurance policy provided that, in addition to the policy limits, insurance company would pay all defense costs they incurred, prejudgment interest was not a defense cost within the meaning of the policy. Sproles v. Greene, 329 N.C. 603, 407 S.E.2d 497 (1991).

Liability of Insurer for Prejudgment Interest. —

A liability carrier's obligation to pay prejudgment interest in addition to its stated limits is governed solely by the language of the policy. Nationwide Mut. Ins. Co. v. Mabe, 115 N.C. App. 193, 444 S.E.2d 664 (1994), aff'd, 342 N.C. 482, 467 S.E.2d 34 (1996).

Insurance company was obligated to pay prejudgment interest as part of the total of any damages up to its liability limit; therefore, where the total judgments exceeded the policy's limit of liability, the individual claimants were not entitled to any prejudgment interest. Nationwide Mut. Ins. Co. v. Mabe, 115 N.C. App. 193, 444 S.E.2d 664 (1994), aff'd, 342 N.C. 482, 467 S.E.2d 34 (1996).

There is no statutory provision mandating that insurance carriers pay prejudgment interest that exceeds the stated limit of liability under the terms of the insurance contract, and since this section is not part of the Financial Responsibility Act, it is not written into every insurance policy. Watlington v. North Carolina Farm Bureau Mut. Ins. Co., 116 N.C. App. 110, 446 S.E.2d 614 (1994).

Whether the insurance policy expressly provided that prejudgment interest was calculable as a part of damages and was therefore included under the liability limits of the policy, defendant insurance company was not obligated to pay prejudgment interest above the policy limit of liability. Watlington v. North Carolina Farm Bureau Mut. Ins. Co., 116 N.C. App. 110, 446 S.E.2d 614 (1994).

The language of a liability carrier's policy controls the liability carrier's obligation to pay prejudgment interest in addition to its stated limits. Nationwide Mut. Ins. Co. v. Mabe, 342 N.C. 482, 467 S.E.2d 34 (1996).

Nothing prevents a liability insurer from defining "damages" to include prejudgment interest and then capping the amount of damages that can be paid. Nationwide Mut. Ins. Co. v. Mabe, 342 N.C. 482, 467 S.E.2d 34 (1996).

Prejudgment Interest from Date of Filing Complaint. —

The Court of Appeals has interpreted the plain language of this section to allow prejudgment interest to accrue from the time the action is instituted. Roberts v. Young, 120 N.C. App. 720, 464 S.E.2d 78 (1995).

Prejudgment Interest on Limits of Policy and Excess. — Where trial court granted prejudgment interest on only $5,000 that remained due on $30,000 judgment after subtracting $25,000 policy limits paid by the liability carrier after the filing date of the complaint but before the judgment, the trial court erred in failing to award prejudgment interest on the $25,000 paid by the liability carrier from the filing date until it was paid by the liability carrier. Regarding the remaining $5,000, prejudgment interest should have been taxed from the date of filing to the time of judgment as a cost, less any interest already paid. Beaver v. Hampton, 106 N.C. App. 172, 416 S.E.2d 8 (1992), rev'd in part and aff'd in part, 333 N.C. 455, 427 S.E.2d 317 (1993).

In breach of contract actions interest is to be paid from the date of breach; therefore, plaintiff's petition for prejudgment interest was improperly denied. Kurtzman v. Applied Analytical Indus., Inc., 125 N.C. App. 261, 480 S.E.2d 425 (1997).

Action Against Underinsured Motorist Carrier. — Underinsured motorist carrier was obligated to pay prejudgment interest, up to its policy limits, on the compensatory damages award of the jury in the underlying tort action by its insured against the tort-feasor. Baxley v. Nationwide Mut. Ins. Co., 334 N.C. 1, 430 S.E.2d 895 (1993).

Prejudgment Interest Not a Cost. — Unless a policy of insurance provides to the contrary, prejudgment interest constitutes a portion of a plaintiff's damage award and not a cost. Ledford v. Nationwide Mut. Ins. Co., 118 N.C. App. 44, 453 S.E.2d 866 (1995).

Principal and Interest Not Distinguished. — The trial court did not err in awarding prejudgment interest when the jury did not distinguish between principal and interest, as the requirement that the jury distinguish between principal and interest pertains only to those rare situations where evidence as to both principal and interest is submitted to the jury for their consideration. Taha v. Thompson, 120 N.C. App. 697, 463 S.E.2d 553 (1995).

§ 24-8. Loans not in excess of $300,000; what interest, fees and charges permitted.

No lender shall charge or receive from any borrower or require in connection with a loan any borrower, directly or indirectly, to pay, deliver, transfer or convey or otherwise confer upon or for the benefit of the lender or any other person, firm or corporation any sum of money, thing of value or other consideration other than that which is pledged as security or collateral to secure the repayment of the full principal of the loan, together with fees and interest provided for in this Chapter or Chapter 53 of the North Carolina General Statutes, where the principal amount of a loan is not in excess of three hundred thousand dollars ($300,000.00); provided, this section shall not prevent a borrower from selling, transferring, or conveying property other than security or collateral to any person, firm or corporation for a fair consideration so long as such transaction is not made a condition or requirement for any loan; provided that this shall not prevent the lender from collecting from the borrower for remittance to others, money in payment of taxes, assessments, cost of upkeep, recording fees, surveys, attorneys' fees, fire, title, life, accident and health, unemployment, and mortgage insurance premiums and other such fees and costs, nor from receiving the proceeds from any insurance policies where a loss occurs under the terms of such policies. This section shall not be applicable to any corporation licensed as a "Small Business Investment Company" under the provisions of the United States Code Annotated, Title 15, section 661, et seq. nor shall it be applicable to the sale or purchase of convertible debentures, nor to the sale or purchase of any debt security with accompanying warrants, nor to the sale or purchase of other securities through an organized securities exchange. (1961, c. 1142; 1969, c. 127; c. 1303, s. 5; 1993, c. 226, s. 12.)

CASE NOTES

Stated in West Raleigh Group v. Massachusetts Mut. Life Ins. Co., 809 F. Supp. 384 (E.D.N.C. 1992).

§ 24-9. Loans to certain entities organized for profit not subject to claim or defense of usury.

Notwithstanding any other provision of this Chapter or any other provision of law, any foreign or domestic corporation, limited liability company, or partnership substantially engaged in commercial pursuits for pecuniary gain may agree to pay, and any lender or other person may charge and collect from the entity, interest, fees, and other charges at any rate which the entity may agree or be required to pay and as to any such transaction the claim or defense of usury by the entity and its successors or anyone else in its behalf is prohibited. (1963, c. 753, s. 1; 1965, c. 335; 1969, c. 896; 1979, c. 138, s. 5; 1995, c. 351, s. 13.)

§ 24-9.2: Repealed by Session Laws 1995, c. 351, s. 14, effective October 1, 1995.

§ 24-9.3. Economic development loans.

Fees or other funds paid by borrowers for contribution to loss reserve accounts administered and controlled by nonprofit corporations that are part of State-funded programs that provide loans to promote economic development shall not be considered interest under this Chapter and shall not be subject to claims or defenses of usury. (1995, c. 252, s. 1.)

Editor's Note. — Session Laws 1995, c. 252, s. 2, made this section effective upon ratification. The Act was ratified June 15, 1995.

§ 24-10. Maximum fees on loans secured by real property.

CASE NOTES

Purpose. — The wisdom of the statute, and others like it, is manifest. First the statute preserves freedom of contract, a principle long recognized and jealously guarded in North Carolina. Secondly, the statute recognizes the borrowers and lenders are best able in a free market place to determine for themselves what prepayment terms are acceptable, "reasonable," "proportionate," and "fair." The statute recognizes that prepayment provisions are part an parcel of the overall loan terms and, as such, are better left to the agreement of the parties. West Raleigh Group v. Massachusetts Mut. Life Ins. Co., 809 F. Supp. 384 (E.D.N.C. 1992).

Amount of Lawful Prepayment Premiums Limited. — Loan pre-payment provisions are valid and enforceable; amount of lawful prepayment premiums are limited. In re Carr Mill Mall Ltd. Partnership, 201 Bankr. 415 (Bankr. M.D.N.C. 1996).

Section Held Applicable. — Note executed in connection with a $2.8 million real estate loan was clearly in excess of $100,000 and was not alleged to be a "construction loan"; there could be no serious argument that the partner did not agree upon the contested prepayment provisions, since those provisions were expressly a part of the Note. Accordingly, subsection (b) of this section was applicable to the note and that the enforceability of the prepayment terms of the note was governed by it. West Raleigh Group v. Massachusetts Mut. Life Ins. Co., 809 F. Supp. 384 (E.D.N.C. 1992).

Prepayment Prior to Enactment of § 24-2.4. — Considering the acts of the General Assembly, specifically this section and § 24-1.1A, the law of North Carolina prior to the enactment of § 24-2.4 was that the mortgagor had the right of prepayment when the note was silent. Hatcher v. Rose, 329 N.C. 626, 407 S.E.2d 172 (1991).

§ 24-10.1. Late fees.

(a) Subject to the limitations contained in subsection (b) of this section, any lender may charge a party to a loan or extension of credit governed by the provisions of G.S. 24-1.1, 24-1.2, or 24-1.1A a late payment charge as agreed upon by the parties in the loan contract.

(b) No lender may charge a late payment charge:

(1) In excess of four percent (4%) of the amount of the payment past due; or

(2) In excess of the amount disclosed with particularity to the borrower pursuant to the provisions of the Federal Con-

sumer Credit Protection Act if the transaction is one to which the provisions of that act apply, which in no event shall exceed four percent (4%); or

(3) For any payment unless past due for 15 days or more; provided, however, if the loan is one on which interest on each installment is paid in advance, no late payment charge may be charged until the payment is 30 days past due or more; or

(4) More than once with respect to a single late payment. If a late payment charge is deducted from a payment made on the contract and such deduction results in a subsequent default on a subsequent payment, no late payment charge may be imposed for such default. If a late payment charge has been once imposed with respect to a particular late payment, no such charge shall be imposed with respect to any future payment which would have been timely and sufficient but for the previous default; provided that when a borrower fails to make an installment payment, and the terms of the loan agreement provide that subsequent payments shall first be applied to the past due balance, and the borrower resumes making installment payments but has not paid all past due installments, then the lender may enforce the contract according to its terms, imposing a separate late payment charge for each installment that becomes due until the default is cured; or

(5) On any loan which by its terms calls for repayment of the entire balance in a single payment and not for installments of interest or principal and interest; or

(6) Unless the lender notifies the borrower within 45 days following the date the payment was due that a late payment charge has been imposed for a particular late payment which late payment must be paid unless the borrower can show that the installment was paid in full and on time. No late payment charge may be collected from any borrower if the borrower informs the lender that non-payment of an installment is in dispute and presents proof of payment within 45 days of receipt of the lender's notice of the late charge.

(c) The provisions of this subsection apply only to home loans made by lenders described in G.S. 24-1.1A(a)(2). Notwithstanding that the note or other loan document sets forth a late payment charge in excess of that permitted in this section, the loan shall not be deemed to be unlawful if:

(1) No late fee in excess of those permitted in this section has been assessed or collected by the lender; and

(2)a. If the loan is executed on or after July 14, 1993, the lender provides written notice to the borrower within 90 days of the date of execution of the loan documents that the late payment charge with respect to the loan shall be four percent (4%) or less; or

b. If the loan was executed prior to July 14, 1993, the lender provides written notice to the borrower within six months of that date that the late payment charge with respect to the loan shall be four percent (4%) or less. (1985, c. 755, s. 1; 1987, c. 447; 1993, c. 339, s. 1.)

Legal Periodicals. — For survey on usury law, see 70 N.C.L. Rev. 1983 (1992).

CASE NOTES

Penalty fees for late payments are "interest" and are compensation for the detention of money owed another, and all such compensation must be forfeited when its rate is usurious, as defined by the laws of this state. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

Change for Lender's Forbearance in Collecting Charge Is Interest. — Just as a charge for a creditor's forbearance in the collection of a debt is interest, so a charge for a lender's forbearance in collecting a payment due is interest. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

Penalty Provisions of § 24-2 Applicable. — The General Assembly, which specified a maximum legal rate for late payment fees in this section, considered such fees "interest" and intended to induce observance of that law through the penalty provisions of § 24-2. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

Violator Not Required to Forfeit Interest Due on Loan Itself. — The statutory penalty for usury requires a defendant which has charged late payments in excess of the legal maximum rate permitted by former § 24-10(e) (see now this section) to forfeit all late payment charges to which it might otherwise have been entitled under the terms of the loan, but defendant is not required to forfeit the interest due on the loan itself. Swindell v. Federal Nat'l Mtg. Assoc., 330 N.C. 153, 409 S.E.2d 892 (1991).

Cited in Beau Rivage Plantation, Inc. v. Melex USA, Inc., 112 N.C. App. 446, 436 S.E.2d 152 (1993).

§ 24-11. Certain revolving credit charges.

(a) On the extension of credit under an open-end credit or similar plan (including revolving credit card plans, and revolving charge accounts, but excluding any loan made directly by a lender under a check loan, check credit or other such plan) under which no service charge shall be imposed upon the consumer or debtor if the account is paid in full within 25 days from the billing date, but upon which there may be imposed an annual charge not to exceed twenty-four dollars ($24.00), there may be charged and collected interest, finance charges or other fees at a rate in the aggregate not to exceed one and one-half percent (1½%) per month computed on the unpaid portion of the balance of the previous month less payments or credit within the billing cycle or the average daily balance outstanding during the current billing period.

(a1) If the lender chooses not to impose an annual charge under this section, the lender may impose a service charge not to exceed two dollars ($2.00) per month on the balance of any account which is not paid in full within 25 days from the billing date.

(a2) No person, firm or corporation may charge a discount or fee in excess of six percent (6%) of the principal amount of the accounts acquired from or through any vendors or others providing services who participate in such plan.

(b) On revolving credit loans (including check loans, check credit or other revolving credit plans whereby a bank, banking institution or other lending agency makes direct loans to a borrower), if agreed to in writing by the borrower, such lender may collect interest and service charges by application of a monthly periodic rate computed on the average daily balance outstanding during the billing period, such rate not to exceed one and one-half percent (1½%).

(c) Any extension of credit under an open-end or similar plan under which there is charged a monthly periodic rate greater than one and one-quarter percent (1¼%) may not be secured by real or personal property or any other thing of value, provided, that this subsection shall not apply to consumer credit sales regulated by Chapter 25A, the Retail Installment Sales Act; provided further, that in any action initiated for the possession of property in which a security interest has been taken, a judgement for the possession thereof shall be restricted to commercial units (as defined in G.S. 25-2-105(6)) for which the cash price was one hundred dollars ($100.00) or more.

(d) The term "billing date" shall mean any date selected by the creditor and the bill for the balance of the account must be mailed to the customer at least 14 days prior to the date specified in the statement as being the date by which payment of the new balance must be made in order to avoid the imposition of any finance charge.

(d1) A lender may charge a party to a loan or extension of credit governed by this section a late payment charge not to exceed five dollars ($5.00) on accounts having an outstanding balance of less than one hundred dollars ($100.00) and ten dollars ($10.00) on accounts having an outstanding balance of one hundred dollars ($100.00) or more, for any payment past due for 30 days or more; provided, in no case shall the late charge exceed the outstanding principal balance. If a late payment charge has been once imposed with respect to a late payment, no late charge shall be imposed with respect to any future payment which would have been timely and sufficient but for the previous default.

(e) An annual or service charge pursuant to this section upon an existing credit card account upon which the charge has not previously been imposed may not be imposed unless the lender has given the cardholder at least 30 days notice of the proposed charge, and has advised the cardholder of his right not to accept the new charge. This notice shall be bold and conspicuous, and shall be on the face of the periodic billing statement or on a separate statement which is clearly noted on the face of the periodic billing statement provided to the cardholder. If the cardholder does not accept the new charge upon an existing credit card account, the lender may require that the cardholder make no further use of the account beyond the 30-day period in order to avoid paying the annual charge, but the cardholder shall be entitled to pay off any remaining balance according to the terms of the credit agreement. Nothing in this subsection shall limit the lender from decreasing any rates or fees to the cardholder forthwith. Should any cardholder within 12 months of the initial imposition of an annual charge rescind his credit card contract and surrender all cards issued under the contract to the lender, he shall be entitled to a prorated refund of the annual fee previously charged, credited to the cardholder's credit card account. (1967, c. 852, s. 1.1; 1969, c. 1303, s. 7; 1977, c. 148, s. 1; cc. 917, 1108; 1979, 2nd Sess., c. 1330, s. 3; 1981, c. 844, s. 1; 1983, c. 126, ss. 5, 10; 1991, c. 506, s. 6; c. 761, s. 45; 1995, c. 387, s. 2.)

Editor's Note. — Session Laws 1995, c. 387, s. 2, amended this section effective July 1, 1995, and applicable to payments due and payable on or after that date.

CASE NOTES

Cited in Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

§ 24-11.1. Disclosure requirements for credit cards.

Editor's Note. — The reference in subsection (c) of this section, which appears in the main volume, to 12 C.R.F. 226 is probably intended to be 12 C.F.R. 226.

Article 2.

Loans Secured by Secondary or Junior Mortgages.

§ 24-14. Limitations on charges and interest.

(a) No person, copartnership, association, trust, corporation or other legal entity making loans under this Article may charge, take or receive, directly or indirectly, simple interest in excess of one and one-half percent (1½%) per month or an annual rate equivalent to the Federal Discount Rate plus five percent (5%), whichever is the greater, computed on the actual or average daily unpaid balance of the principal amount of the loan for the time actually outstanding. However, interest may not be compounded.

(b) In addition to the interest permitted in subsection (a), the lender may include in the loan his actual expenses which are paid to third parties in connection with the loan. Such expenses shall be limited to those for: title examination, title insurance, appraisals, surveys, and recording fees or releasing fees to trustees or public officials, and only such insurance charges as permitted in subsection (c).

(c) Evidence of hazard insurance may be required by the lender of the borrower. Credit life, credit accident and health, and credit unemployment insurance, or any of them, may be offered but not required; provided (i) that the borrower has indicated a desire to purchase such insurance by signing a statement to that effect, (ii) that the borrower is advised that he may acquire this insurance from any insurance carrier, (iii) that the borrower is aware that this insurance may be rescinded within 30 days after receipt of the policy or certificate, and (iv) that the borrower directs the lender to purchase the above insurance from the proceeds of his loan.

The rates for the herein described insurance shall not exceed the standard rates approved by the Commissioner of Insurance for such insurance. Proof of all insurance issued in connection with loans subject to this Article shall be furnished to the borrower within 10 days from the date of application therefor by said borrower.

(d) No application fee or other charge shall be allowed in the event the loan is not consummated.

(e) The borrower shall further have the right to anticipate payment of his debt in whole or in part at any time, without payment of interest penalty, or any other fee or charge for such prepayment.

(f) In addition to the interest permitted by subsection (a), the lender may include in the principal balance fees or discounts not exceeding two percent (2%) of the principal amount of the loan less the amount of any existing loan by that lender to be refinanced, modified or extended. The fees and discounts are fully earned when the loan is made and are not a prepayment penalty. (1971, c. 1229, s. 2; 1973, c. 1150; 1977, c. 698, ss. 1, 2; 1979, 2nd Sess., c. 1157, ss. 5, 6; 1985, c. 154, s. 4; 1993, c. 226, s. 13.)

§ 24-17. Misdemeanors.

A wilful or knowing violation of G.S. 24-12 through G.S. 24-16 is hereby made a Class 1 misdemeanor. (1971, c. 1229, s. 2; 1993, c. 539, s. 400; 1994, Ex. Sess., c. 24, s. 14(c).)

Editor's Note. — Session Laws 1993, c. 539, s. 400, which amended this section, in s. 1359, as amended by Session Laws 1994, Extra Session, c. 24, s. 14(c), provides: "This act becomes effective October 1, 1994, and applies to offenses occurring on or after that date. Prosecutions for offenses committed before the effective date of this act are not abated or affected by this act, and the statutes that would be applicable but for this act remain applicable to those prosecutions."

Chapter 25.
Uniform Commercial Code.

Article 1.

General Provisions.

Part 1. Short Title, Construction, Application and Subject Matter of the Act.

Sec.
25-1-105. Territorial application of the act; parties' power to choose applicable law.

Part 2. General Definitions and Principles of Interpretation.

25-1-206. Statute of frauds for kinds of personal property not otherwise covered.

Article 3.

Negotiable Instruments.

(Revised) .

Part 5. Dishonor.

25-3-506. Collection of processing fee for returned checks.

Article 4.

Bank Deposits and Collections.

Part 1. General Provisions and Definitions.

25-4-104. Definitions and index of definitions.

Article 5.

Letters of Credit.

25-5-114. Issuer's duty and privilege to honor; right to reimbursement.

Article 8.

Investment Securities.

Part 1. Short Title and General Matters.

25-8-101. Short title.
25-8-102. Definitions.
25-8-103. Rules for determining whether certain obligations and interests are securities or financial assets.
25-8-104. Acquisition of security or financial asset or interest therein.
25-8-105. Notice of adverse claim.
25-8-106. Control.
25-8-107. Whether indorsement, instruction, or entitlement order is effective.
25-8-108. Warranties in direct holding.
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25-8-110. Applicability; choice of law.
25-8-111. Clearing corporation rules.
25-8-112. Creditor's legal process.
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ARTICLE 1.

General Provisions.

PART 1.

SHORT TITLE, CONSTRUCTION, APPLICATION AND SUBJECT MATTER OF THE ACT.

§ 25-1-102. Purposes; rules of construction; variation by agreement.

CASE NOTES

Cited in Alamance County Bd. of Educ. v. Bobby Murray Chevrolet, Inc., 121 N.C. App. 222, 465 S.E.2d 306 (1996).

§ 25-1-103. Supplementary general principles of law applicable.

CASE NOTES

Cited in Mountain Farm Credit Serv. v. Purina Mills, Inc., 119 N.C. App. 508, 459 S.E.2d 75 (1995); Alamance County Bd. of Educ. v. Bobby Murray Chevrolet, Inc., 121 N.C. App. 222, 465 S.E.2d 306 (1996).

§ 25-1-105. Territorial application of the act; parties' power to choose applicable law.

(1) Except as provided hereafter in this section, when a transaction bears a reasonable relation to this State and also to another state or nation the parties may agree that the law either of this State or of such other state or nation shall govern their rights and duties. Failing such agreement this chapter applies to transactions bearing an appropriate relation to this State.

(2) Where one of the following provisions of this Chapter specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

Rights of creditors against sold goods. (G.S. 25-2-402).

Applicability of the article on bank deposits and collections. (G.S. 25-4-102).

Bulk transfers subject to the article on bulk transfers. (G.S. 25-6-102).

Applicability of the article on investment securities. (G.S. 25-8-110).

Perfection provisions of the article on secured transactions. (G.S. 25-9-103).

Governing law in the article on Funds Transfers. (G.S. 25-4A-507). (1965, c. 700, s. 1; 1975, c. 862, s. 1; 1993, c. 157, s. 2; 1997-181, s. 17.)

Effect of Amendments. — The 1997 amendment, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, substituted "(G.S. 25-8-110)" for "(G.S. 25-8-106)" in subdivision (2).

CASE NOTES

Actions Based on Breach of Warranty, etc. —

Where defendant, a North Carolina brake manufacturer, initially distributed his product from North Carolina into Kentucky, and plaintiff's injury as a result of a malfunction of brakes supplied by defendant took place in North Carolina, North Carolina law applied to plaintiff's breach of warranty claim. Mahoney v. Ronnie's Road Serv., 122 N.C. App. 150, 468 S.E.2d 279 (1996).

Cited in J.M. Smith Corp. v. Matthews, 123 N.C. App. 771, 474 S.E.2d 798 (1996).

PART 2.

General Definitions and Principles of Interpretation.

§ 25-1-201. General definitions.

CASE NOTES

Stated in Smithers v. Tru-Pak Moving Sys., 121 N.C. App. 542, 468 S.E.2d 410 (1996).

§ 25-1-203. Obligation of good faith.

CASE NOTES

Cited in Wachovia Bank & Trust Co. v. Carrington Dev. Assocs., 119 N.C. App. 480, 459 S.E.2d 17 (1995).

§ 25-1-206. Statute of frauds for kinds of personal property not otherwise covered.

(1) Except in the cases described in subsection (2) of this section a contract for the sale of personal property is not enforceable by way of action or defense beyond five thousand dollars ($5,000.00) in amount or value of remedy unless there is some writing which indicates that a contract for sale has been made between the parties at a defined or stated price, reasonably identifies the subject matter,

and is signed by the party against whom enforcement is sought or by his authorized agent.

(2) Subsection (1) of this section does not apply to contracts for the sale of goods (G.S. 25-2-201) nor of securities (G.S. 25-8-113) nor to security agreements (G.S. 25-9-203). (1965, c. 700, s. 1; 1997-181, s. 18.)

Effect of Amendments. — The 1997 amendment, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, substituted "(G.S. 25-8-113)" for "(G.S. 25-8-319)" in subdivision (2).

ARTICLE 2.

Sales.

PART 1.

SHORT TITLE, GENERAL CONSTRUCTION AND SUBJECT MATTER.

§ 25-2-102. Scope; certain security and other transactions excluded from this article.

CASE NOTES

Cited in Haywood Street Redevelopment Corp. v. Harry S. Peterson, Co., 120 N.C. App. 832, 463 S.E.2d 564 (1995); In re Surplus Furniture Liquidators, Inc., 199 Bankr. 136 (Bankr. M.D.N.C. 1995).

PART 2.

FORM, FORMATION AND READJUSTMENT OF CONTRACT.

§ 25-2-201. Formal requirements; statute of frauds.

CASE NOTES

Cited in Computer Decisions, Inc. v. Rouse Office Mgt. of N.C., Inc., 124 N.C. App. 383, 477 S.E.2d 262 (1996).

§ 25-2-202. Final written expression; parol or extrinsic evidence.

Legal Periodicals. —

For article, "Drawing the Boundary Between Copyright and Contract: Copyright Preemption of Software License Terms", see 45 Duke L.J. 479 (1995).

CASE NOTES

Parole Evidence Held Inadmissible. — Although defendant's oral statements concerning the condition of the automobile were parole evidence and inadmissible to contradict the terms of a written contract, the evidence was not offered to contradict the contract, but rather to prove an unfair or deceptive practice. Torrance v. AS & L Motors, Ltd., 119 N.C. App. 552, 459 S.E.2d 67 (1995).

PART 3.

GENERAL OBLIGATION AND CONSTRUCTION OF CONTRACT.

§ 25-2-302. Unconscionable contract or clause.

Legal Periodicals. —

For article, "Drawing the Boundary Between Copyright and Contract: Copyright Preemption of Software License Terms", see 45 Duke L.J. 479 (1995).

§ 25-2-314. Implied warranty: Merchantability; usage of trade.

CASE NOTES

Privity Not Abolished for Employees. — A buyer's employee is barred from suit against a seller grounded upon breach of implied warranty in that neither the Act nor the U.C.C. provisions regarding implied warranties abolish the privity requirement in such instance. Nicholson v. American Safety Util. Corp., 124 N.C. App. 59, 476 S.E.2d 672 (1996).

§ 25-2-316. Exclusion or modification of warranties.

Legal Periodicals. —

For article, "Drawing the Boundary Between Copyright and Contract: Copyright Preemption of Software License Terms", see 45 Duke L.J. 479 (1995).

CASE NOTES

Cited in Torrance v. AS & L Motors, Ltd., 119 N.C. App. 552, 459 S.E.2d 67 (1995).

PART 4.

TITLE, CREDITORS AND GOOD FAITH PURCHASERS.

§ 25-2-401. Passing of title; reservation for security; limited application of this section.

CASE NOTES

Cited in In re Surplus Furniture Liquidators, Inc., 199 Bankr. 136 (Bankr. M.D.N.C. 1995).

PART 5.

PERFORMANCE.

§ 25-2-501. Insurable interest in goods; manner of identification of goods.

CASE NOTES

Cited in In re Surplus Furniture Liquidators, Inc., 199 Bankr. 136 (Bankr. M.D.N.C. 1995).

§ 25-2-502. Buyer's right to goods on seller's insolvency.

CASE NOTES

Cited in In re Surplus Furniture Liquidators, Inc., 199 Bankr. 136 (Bankr. M.D.N.C. 1995).

PART 6.

BREACH, REPUDIATION AND EXCUSE.

§ 25-2-615. Excuse by failure of presupposed conditions.

CASE NOTES

A seller of goods may limit its liability by inclusion of a single source clause. Alamance County Bd. of Educ. v. Bobby Murray Chevrolet, Inc., 121 N.C. App. 222, 465 S.E.2d 306 (1996).

Burden of Loss on Seller. — Failure to make express provision for a foreseeable contingency in a sales contract implicitly places the burden of loss on the seller when the contingency comes to fruition. Alamance County Bd. of Educ. v. Bobby Murray Chevrolet, Inc., 121

N.C. App. 222, 465 S.E.2d 306 (1996).

Risk of Governmental Regulation. — Generally, governmental regulations do not excuse performance under a contract where a party has assumed the risk of such regulation. Thus, defendant, by terms of the parties' agreement, accepted responsibility for keeping abreast of governmental regulations bearing upon the contract. Alamance County Bd. of Educ. v. Bobby Murray Chevrolet, Inc., 121 N.C. App. 222, 465 S.E.2d 306 (1996).

PART 7.

Remedies.

§ 25-2-710. Seller's incidental damages.

CASE NOTES

Seller May Recover Expenses Reasonably Incurred. —

In order to prevent the imposition of increased liability on sellers of goods who reasonably exercise their state law rights, when a seller acts in good faith and resells returned goods in a commercially reasonable manner, the amount that may be recovered as a preference is the amount netted by the seller after costs and expenses have been deducted form the gross proceeds of any such sale. In re American Furniture Outlet USA, Inc. v. Woodmark Originals, Inc., (Bnkr. M.D.N.C. 1997), 209 B.R. 49 (1997).

An aggrieved seller (who acts in a commercially reasonable manner) is entitled to recover the costs associated with the care and resale of rejected goods after a buyer's breach. In re American Furniture Outlet USA, Inc. v. Woodmark Originals, Inc., (Bnkr. M.D.N.C. 1997), 209 B.R. 49 (1997).

Effect of Bankruptcy. — Where defendant acted in a commercially reasonable manner and, absent bankruptcy by debtor, would have been entitled to collect costs and expenses associated with the sales as part of its damages claim, it would not be equitable to require defendant to assume those costs simply because the debtor filed bankruptcy. In re American Furniture Outlet USA, Inc. v. Woodmark Originals, Inc., (Bnkr. M.D.N.C. 1997), 209 B.R. 49 (1997).

§ 25-2-715. Buyer's incidental and consequential damages.

CASE NOTES

Proximate Cause Required for Consequential Damages. — Without proximate cause of the injury by the breach of the warranty, consequential damages are not recoverable. Edwards v. Atro Spa, 891 F. Supp. 1074 (E.D.N.C. 1995).

§ 25-2-716. Buyer's right to specific performance or replevin.

CASE NOTES

Specific Performance Unwarranted. — Where furniture which the objecting customer was seeking to obtain was of the type which could be easily purchased from furniture manufacturers and other retailers in the geographical area where debtor was located, furniture was not so unique as to merit specific performance. In re Surplus Furniture Liquidators, Inc., 199 Bankr. 136 (Bankr. M.D.N.C. 1995).

Replevin Unavailable. — Where there was no evidence that an objecting customer made reasonable efforts to effect cover for furniture in possession of debtor, and customer would not be unable to effect cover, replevin was unavailable. In re Surplus Furniture Liquidators, Inc., 199 Bankr. 136 (Bankr. M.D.N.C. 1995).

§ 25-2-725. Statute of limitations in contracts for sale.

CASE NOTES

Cited in Haywood Street Redevelopment Corp. v. Harry S. Peterson, Co., 120 N.C. App. 832, 463 S.E.2d 564 (1995); Hudson v. Game World, Inc., — N.C. App. —, 484 S.E.2d 435 (1997).

ARTICLE 3.

Negotiable Instruments.

(Revised)

PART 1.

GENERAL PROVISIONS AND DEFINITIONS.

§ 25-3-110. Identification of person to whom instrument is payable.

CASE NOTES

Stated in Upchurch v. Upchurch, 122 N.C. App. 172, 468 S.E.2d 61 (1996).

PART 4.

LIABILITY OF PARTIES.

§ 25-3-403. Unauthorized signature.

CASE NOTES

I. Decisions under Prior Version of Article 3.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

No Relationship Between Indorser and Payee. — Where company did not authorize indorsement of its checks, or payment of the proceeds thereof, to any other entity, there was no agency relationship between the indorser of the checks, which was an entity which was being used to conceal embezzlement of funds, and the company as payee of the checks. Knight Publishing Co. v. Chase Manhattan Bank, 125 N.C. App. 1, 479 S.E.2d 478 (1997).

§ 25-3-405. Employer's responsibility for fraudulent indorsement by employee.

CASE NOTES

Effect of 1995 Amendment. — The phrase "in the name of a named payee" in the version of this section prior to the 1995 amendment was clarified by the amendment, and required an indorsement not identical to the name of the payee, but rather "substantially similar" to it. Knight Publishing Co. v. Chase Manhattan Bank, 125 N.C. App. 1, 479 S.E.2d 478 (1997).

Application of this section was precluded where the indorser of a check could not be characterized as substantially similar to the named payee; the addition of certain words signified that the indorser was an entity distinct from the named payee. Knight Publishing Co. v. Chase Manhattan Bank, 125 N.C. App. 1, 479 S.E.2d 478 (1997).

§ 25-3-406. Negligence contributing to forged signature or alteration of instrument.

CASE NOTES

Cited in Knight Publishing Co. v. Chase Manhattan Bank, 125 N.C. App. 1, 479 S.E.2d 478 (1997).

§ 25-3-408. Drawee not liable on unaccepted draft.

CASE NOTES

I. Decisions Under Prior Law.

I. DECISIONS UNDER PRIOR LAW.

The transfer of a check does not operate as an assignment of money on deposit; therefore, where defendant did not cash check before testatrix's death, the money was never delivered from testatrix to defendant and the attempted gift was incomplete. Creekmore v. Creekmore, — N.C. App. —, 485 S.E.2d 68 (1997).

§ 25-3-415. Obligation of indorser.

CASE NOTES

I. Decisions under Prior Version of Article 3.

I. DECISIONS UNDER PRIOR VERSION OF ARTICLE 3.

Borrower as Co-Maker Not Accommodation Party. — Borrower had a real interest in the proceeds of the note that she signed, and was not an accommodation party where she signed the note as a co-maker, and not as an accommodation party, she signed the promissory note, exactly as husband did on a line under the heading of "Borrower" and, by signing the note, subjected herself to liability on its full amount; husband testified that in preparation for the loan, he gave the bank a joint financial statement, and both of them signed a joint note and deed of trust. Butler v. NationsBank, 58 F.3d 1022 (4th Cir. 1995).

PART 5.

DISHONOR.

§ 25-3-506. Collection of processing fee for returned checks.

A person who accepts a check in payment for goods or services may charge and collect a processing fee, not to exceed twenty-five dollars ($25.00), for a check on which payment has been refused by the payor bank because of insufficient funds or because the drawer did not have an account at that bank if at the time the consumer presented the check to the person, a sign:

(1) Was conspicuously posted on or in the immediate vicinity of the cash register or other place where the check is received;
(2) Was in plain view of anyone paying for goods or services by check;
(3) Was no smaller than 8 by 11 inches; and
(4) Stated the amount of the fee that would be charged for returned checks.

When the drawer sends a check by mail for payment of a debt and the check is dishonored and returned, the processing fee may be collected if the drawer was given prior written notice that a fee would be charged for returned checks. Any document that clearly and conspicuously states the amount of the fee that will be charged for returned checks and is delivered to the drawer or his agent, or is mailed first-class mail to the drawer at his last known address as part of any document requesting payment of a debt satisfies this notice requirement for that payment only.

If a collection agency collects or seeks to collect on behalf of its principal a processing fee as specified in this section in addition to the sum payable of a check, the amount of such processing fee must be separately stated on the collection notice. The collection agency shall not collect or seek to collect from the drawer any sum other than the actual amount of the returned check and the specified processing fee. (1981, c. 781, s. 1; 1983, c. 529; 1987, c. 147; 1991, c. 455, s. 1; 1995, c. 232, s. 1; 1997-334, s. 1.)

Effect of Amendments. — The 1997 amendment, effective October 1, 1997, and applicable to checks written on or after that date, substituted "twenty-five dollars ($25.00)" for "twenty dollars ($20.00)."

ARTICLE 4.

Bank Deposits and Collections.

PART 1.

GENERAL PROVISIONS AND DEFINITIONS.

§ 25-4-102. Applicability.

CASE NOTES

Cited in Knight Publishing Co. v. Chase Manhattan Bank, 125 N.C. App. 1, 479 S.E.2d 478 (1997).

§ 25-4-104. Definitions and index of definitions.

(a) In this Article, unless the context otherwise requires:

(1) "Account" means any deposit or credit account with a bank, including a demand, time, savings, passbook, share draft, or like account, other than an account evidenced by a certificate of deposit.

(2) "Afternoon" means the period of a day between noon and midnight.

(3) "Banking day" means the part of a day on which a bank is open to the public for carrying on substantially all of its banking functions.

(4) "Clearing house" means an association of banks or other payors regularly clearing items.

(5) "Customer" means a person having an account with a bank or for whom a bank has agreed to collect items, including a bank that maintains an account at another bank.

(6) "Documentary draft" means a draft to be presented for acceptance or payment if specified documents, certificated securities (G.S. 25-8-102) or instructions for uncertificated securities (G.S. 25-8-102), or other certificates, statements, or the like are to be received by the drawee or other payor before acceptance or payment of the draft.

(7) "Draft" means a draft as defined in G.S. 25-3-104 or an item, other than an instrument, that is an order.

(8) "Drawee" means a person ordered in a draft to make payment.

(9) "Item" means an instrument or a promise or order to pay money handled by a bank for collection or payment. The term does not include a payment order governed by Article 4A or a credit or debit card slip.

(10) "Midnight deadline" with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later.

(11) "Settle" means to pay in cash, by clearing-house settlement, in a charge or credit, by remittance, or otherwise as agreed. A settlement may be either provisional or final.

(12) "Suspends payments" with respect to a bank means that it has been closed by order of the supervisory authorities, that a public officer has been appointed to take it over, or that it ceases or refuses to make payments in the ordinary course of business.

(b) Other definitions applying to this Article and the sections in which they appear are:

"Agreement for electronic presentment"	G.S. 25-4-110.
"Bank"	G.S. 25-4-105.
"Collecting bank"	G.S. 25-4-105.
"Depositary bank"	G.S. 25-4-105.
"Intermediary bank"	G.S. 25-4-105.
"Payor bank"	G.S. 25-4-105.
"Presenting bank"	G.S. 25-4-105.
"Presentment notice"	G.S. 25-4-110.

(c) The following definitions in other Articles apply to this Article:

"Acceptance"	G.S. 25-3-409.
"Alteration"	G.S. 25-3-407.
"Cashier's check"	G.S. 25-3-104.
"Certificate of deposit"	G.S. 25-3-104.
"Certified check"	G.S. 25-3-409.
"Check"	G.S. 25-3-104.
"Good faith"	G.S. 25-3-103.
"Draft"	G.S. 25-3-104.
"Holder in due course"	G.S. 25-3-302.
"Instrument"	G.S. 25-3-104.
"Notice of dishonor"	G.S. 25-3-503.
"Order"	G.S. 25-3-103.
"Ordinary care"	G.S. 25-3-103.
"Person entitled to enforce"	G.S. 25-3-301.
"Presentment"	G.S. 25-3-501.
"Promise"	G.S. 25-3-103.
"Prove"	G.S. 25-3-103.
"Teller's check"	G.S. 25-3-104.
"Unauthorized signature"	G.S. 25-3-403.

(d) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article. (1965, c. 700, s. 1; 1995, c. 232, s. 2; 1997-181, s. 19.)

Effect of Amendments. — The 1997 amendment, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, substituted "(G.S. 25-8-102)" for "(G.S. 25-8-308)" in subdivision (a)(6).

PART 4.

RELATIONSHIP BETWEEN PAYOR BANK AND ITS CUSTOMER.

§ 25-4-401. When bank may charge customer's account.

CASE NOTES

Checks made payable to the order of one payee but indorsed by someone other than the named payee were not properly payable, and by charging the checks against a customer's account, drawee bank breached its duty to charge customer's account only for items properly payable. Knight Publishing Co. v. Chase Manhattan Bank, 125 N.C. App. 1, 479 S.E.2d 478 (1997).

Article 5.

Letters of Credit.

§ 25-5-114. Issuer's duty and privilege to honor; right to reimbursement.

(1) An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary. The issuer is not excused from honor of such a draft or demand by reason of an additional general term that all documents must be satisfactory to the issuer, but an issuer may require that specified documents must be satisfactory to it.

(2) Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (G.S. 25-7-507) or of a certificated security (G.S. 25-8-108) or is forged or fraudulent or there is fraud in the transaction

(a) the issuer must honor the draft or demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (G.S. 25-3-302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (G.S. 25-7-502) or a protected purchaser of a certificated security (G.S. 25-8-303); and

(b) in all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor.

(3) Unless otherwise agreed an issuer which has duly honored a draft or demand for payment is entitled to immediate reimbursement of any payment made under the credit and to be put in effectively available funds not later than the day before maturity of any acceptance made under the credit. (1965, c. 700, s. 1; 1989 (Reg. Sess., 1990), c. 1024, s. 8(d); 1997-181, s. 20.)

Effect of Amendments. — The 1997 amendment, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, substituted "(G.S. 25-8-108)" for "(G.S. 25-8-306)" in subdivision (2).

ARTICLE 6.

Bulk Transfers.

§ 25-6-104. Schedule of property, list of creditors.

Legal Periodicals. — For comment, "Beyond Budd Tire: Examining Corporate Successor Liability in North Carolina," see 30 Wake Forest L. Rev. 889 (1995).

§ 25-6-105. Notice to creditors.

Legal Periodicals. — For comment, "Beyond Budd Tire: Examining Corporate Successor Liability in North Carolina," see 30 Wake Forest L. Rev. 889 (1995).

ARTICLE 7.

Warehouse Receipts, Bills of Lading and Other Documents of Title.

PART 1.

GENERAL.

§ 25-7-102. Definitions and index of definitions.

CASE NOTES

Cited in In re Aerospace Technologies, Inc., 199 Bankr. 331 (Bankr. M.D.N.C. 1996).

PART 2.

WAREHOUSE RECEIPTS: SPECIAL PROVISIONS.

§ 25-7-202. Form of warehouse receipt; essential terms; optional terms.

CASE NOTES

Valid Receipt Does Not Require All Listed Terms. — This section does not require that all of the listed terms in this section be included for a warehouse receipt to be valid. Smithers v. Tru-Pak Moving Sys., 121 N.C. App. 542, 468 S.E.2d 410 (1996).

Because an inventory of goods is valid as a warehouse receipt as against defendant, principles of fairness dictate that it should also be valid as a warehouse receipt against plaintiffs who have benefited from the storage of their goods. Smithers v. Tru-Pak Moving Sys., 121 N.C. App. 542, 468 S.E.2d 410 (1996).

Invoice Held Not Receipt. — Where invoice from warehouseman itemized warehouse charges and stated the amount due, invoice did not qualify as a "warehouse receipt" as required for Uniform Commercial Code warehouseman's lien. In re Aerospace Technologies, Inc., 199 Bankr. 331 (Bankr. M.D.N.C. 1996).

§ 25-7-209. Lien of warehouseman.

CASE NOTES

Sheriff Legally Possessed Personal Property Removed from Foreclosed Property. — Where purchaser contracted with moving company to remove personal property from foreclosed property, he did so at the request of the sheriff's deputies, and the sheriff was both the depositor of the goods and the legal possessor as defined in subsection (3)(b). Smithers v. Tru-Pak Moving Sys., 121 N.C. App. 542, 468 S.E.2d 410 (1996).

Warehousemen Rights. — Any rights a warehouseman had were to be analyzed as a warehouseman's lien under chapter 25 rather than as a possessory lien under chapter 44A. Smithers v. Tru-Pak Moving Sys., 121 N.C. App. 542, 468 S.E.2d 410 (1996).

Cited in In re Aerospace Technologies, Inc., 199 Bankr. 331 (Bankr. M.D.N.C. 1996).

PART 3.

BILLS OF LADING: SPECIAL PROVISIONS.

§ 25-7-307. Lien of carrier.

CASE NOTES

Cited in In re Aerospace Technologies, Inc., 199 Bankr. 331 (Bankr. M.D.N.C. 1996).

PART 4.

WAREHOUSE RECEIPTS AND BILLS OF LADING: GENERAL OBLIGATIONS.

§ 25-7-403. Obligation of warehouseman or carrier to deliver; excuse.

CASE NOTES

Stated in Smithers v. Tru-Pak Moving Sys., 121 N.C. App. 542, 468 S.E.2d 410 (1996).

ARTICLE 8.

Investment Securities.

(Revised)

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NORTH CAROLINA COMMENT

This article is based upon Revised Article 8 of the Uniform Commercial Code (hereinafter "Revised Article 8"), which was adopted in 1994 by the National Conference of Commissioners on Uniform State Laws and the American Law Institute. Revised Article 8 updates the prior version of Article 8 of the Uniform Commercial Code to provide a modern legal structure for the system of holding securities through brokers, banks, and other securities intermediaries (hereinafter "indirect holding system") that has developed in the past few decades.

Revised Article 8 defines the nature of the property interest of the customer in the indirect conceptual structure and provisions of the prior version of Article 8 relating to the direct holding of certificated and uncertificated securities, while eliminating ambiguities and inconsistencies that have been found in the prior version of the Article. Provisions governing the creation and perfection of security interests in investment securities, whether held directly or indirectly, are not set out in Revised Article 8 but have been returned to Article 9.

The revised Official Comments of the National Conference of Commissioners on Uniform State Laws and the American Law Institute appear in Revised Article 8 under the heading "Official Comment".

PART 1.

SHORT TITLE AND GENERAL MATTERS.

§ 25-8-101. Short title.

This Article may be cited as Uniform Commercial Code— Investment Securities. (1965, c. 700, s. 1; 1997-181, s. 1.)

Editor's Note. — Session Laws 1997-181, s. 1, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, rewrites Article 8 of Chapter 25 of the General Statutes. Historical citations and case annotations to sections in the former Article 8 have been added to corresponding sections in new Article 8 as recodified. At the end of Article 8 are tables showing comparable sections and their disposition in new Article 8.

Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

§ 25-8-102. Definitions.

(a) In this Article:

(1) "Adverse claim" means a claim that a claimant has a property interest in a financial asset and that it is a violation of the rights of the claimant for another person to hold, transfer, or deal with the financial asset.

(2) "Bearer form", as applied to a certificated security, means a form in which the security is payable to the bearer of the security certificate according to its terms but not by reason of an indorsement.

(3) "Broker" means a person defined as a broker or dealer under the federal securities laws, but without excluding a bank acting in that capacity.

(4) "Certificated security" means a security that is represented by a certificate.

(5) "Clearing corporation" means:

(i) A person that is registered as a "clearing agency" under the federal securities laws;

(ii) A federal reserve bank; or

(iii) Any other person that provides clearance or settlement services with respect to financial assets that would require it to register as a clearing agency under the federal securities laws but for an exclusion or exemption from the registration requirement, if its activities as a clearing corporation, including promulgation of rules, are subject to regulation by a federal or state governmental authority.

(6) "Communicate" means to:

(i) Send a signed writing; or

(ii) Transmit information by any mechanism agreed upon by the persons transmitting and receiving the information.

(7) "Entitlement holder" means a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary. If a person acquires a security entitlement by virtue of G.S. 25-8-501(b)(2)or (3), that person is the entitlement holder.

(8) "Entitlement order" means a notification communicated to a securities intermediary directing transfer or redemption of a financial asset to which the entitlement holder has a security entitlement.

(9) "Financial asset", except as otherwise provided in G.S. 25-8-103, means:

(i) A security;

(ii) An obligation of a person or a share, participation, or other interest in a person or in property or an enterprise of a person, which is, or is of a type, dealt in or traded on financial markets, or which is recognized in any area in which it is issued or dealt in as a medium for investment; or

(iii) Any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under this Article.

As context requires, the term means either the interest itself or the means by which a person's claim to it is evidenced, including a certificated or uncertificated security, a security certificate, or a security entitlement.

(10) "Good faith", for purposes of the obligation of good faith in the performance or enforcement of contracts or duties within this Article, means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(11) "Indorsement" means a signature that alone or accompanied by other words is made on a security certificate in registered form or on a separate document for the purpose of assigning, transferring, or redeeming the security or granting a power to assign, transfer, or redeem it.

(12) "Instruction" means a notification communicated to the issuer of an uncertificated security which directs that the transfer of the security be registered or that the security be redeemed.

(13) "Registered form", as applied to a certificated security, means a form in which:
  (i) The security certificate specifies a person entitled to the security; and
  (ii) A transfer of the security may be registered upon books maintained for that purpose by or on behalf of the issuer, or the security certificate so states.

(14) "Securities intermediary" means:
  (i) A clearing corporation; or
  (ii) A person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity.

(15) "Security", except as otherwise provided in G.S. 25-8-103, means an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer:
  (i) Which is represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer;
  (ii) Which is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations; and
  (iii) Which:
    (A) Is, or is of a type, dealt in or traded on securities exchanges or securities markets; or
    (B) Is a medium for investment and by its terms expressly provides that it is a security governed by this Article.

(16) "Security certificate" means a certificate representing a security.

(17) "Security entitlement" means the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5 of this Article.

(18) "Uncertificated security" means a security that is not represented by a certificate.

(b) Other definitions applying to this Article and the sections in which they appear are:

"Appropriate person"	G.S. 25-8-107.

"Control"	G.S. 25-8-106.
"Delivery"	G.S. 25-8-301.
"Investment company security"	G.S. 25-8-103.
"Issuer"	G.S. 25-8-201.
"Overissue"	G.S. 25-8-210.
"Protected purchaser"	G.S. 25-8-303.
"Securities account"	G.S. 25-8-501.

(c) In addition, Article 1 of this Chapter contains general definitions and principles of construction and interpretation applicable throughout this Article.

(d) The characterization of a person, business, or transaction for purposes of this Article does not determine the characterization of the person, business, or transaction for purposes of any other law, regulation, or rule. (1965, c. 700, s. 1; 1973, c. 497, s. 3; 1989, c. 588, s. 1; 1989 (Reg. Sess., 1990), c. 1024, s. 9(a); 1997-181, s. 1.)

AMENDED OFFICIAL COMMENT

1. "Adverse Claim." The definition of the term "adverse claim" has two components. First, the term refers only to property interests. Second, the term means not merely that a person has a property interest in a financial asset but that it is a violation of the claimant's property interest for the other person to hold or transfer the security or other financial asset.

The term adverse claim is not, of course, limited to ownership rights, but extends to other property interests established by other law. A security interest, for example, would be an adverse claim with respect to a transferee from the debtor since any effort by the second party to enforce the security interest against the property would be an interference with the transferee's interest.

The definition of adverse claim in the prior version of Article 8 might have been read to suggest that any wrongful action concerning a security, even a simple breach of contract, gave rise to an adverse claim. Insofar as such cases as *Fallon v. Wall Street Clearing Corp.*, 586 N.Y.S.2d 953, 182 A.D.2d 245, (1992) and *Pentech Intl. v. Wall St. Clearing Co.*, 983 F.2d 441 (2d Cir. 1993), were based on that view, they are rejected by the new definition which explicitly limits the term adverse claim to property interests. Suppose, for example, that A contract to sell or deliver securities to B, but fails to do so and instead sells or pledges the securities to C. B, the promisee, has an action against A for breach of contract, but absent unusual circumstances the action for breach would not give rise to a property interest in the securities. Accordingly, B does not have an adverse claim. An adverse claim might, however, be based upon principles of equitable remedies that give rise to property claims. It would, for example, cover a right established by other law to rescind a transaction in which securities were transferred. Suppose, for example, that A holds securities and is induced by B's fraud to transfer them to B. Under the law of contract of restitution, A may, have a right to rescind the transfer, which gives A a property claim to the securities. If so, A has an adverse claim to the securities in B's hands. By contrast, if B had committed no fraud, but had merely committed a breach of contract in connection with the transfer from A to B, A may have only a right to damages for breach, not a right to rescind. In that case, A would not have an adverse claim to the securities in B's hands.

2. "Bearer form." The definition of "bearer form" has remained substantially unchanged since the early drafts of the original version of Article 8. The requirement that the certificate be payable to bearer by its terms rather than by an indorsement has the effect of preventing instruments governed by other law, such as chattel paper or Article 3 negotiable instruments, from being inadvertently swept into the Article 8 definition of security merely by virtue of blank indorsements. Although the other elements of the definition of security in Section 8-102(a)(14) probably suffice for that purpose in any event, the language used in the prior version of Article 8 has been retained.

3. "Broker." Broker is defined by reference to the definitions of broker and dealer in the federal securities laws. The only difference is that banks, which are

excluded from the federal securities law definition, are included in the Article 8 definition when they perform functions that would bring them within the federal securities law definition if it did not have the cause excluding banks. The definition covers both those who act as agents ("brokers" in securities parlance) and those who act as principals ("dealers" in securities parlance). Since the definition refers to persons "defined" as brokers or dealers under the federal securities law, rather than to persons required to "register" as brokers or dealers under the federal securities law, it covers not only registered brokers and dealers but also those exempt from the registration requirement, such as purely intrastate brokers. The only substantive rules that turn on the defined term broker are one provision of the section on warranties, Section 8-108(i), and the special perfection rule in Article 9 for security interests granted by brokers, Section 9-115(4)(c).

4. "Certificated security." The term "certificated security" means a security that is represented by a security certificate.

5. "Clearing corporation." The definition of clearing corporation limits its application to entities that are subject to a rigorous regulatory framework. Accordingly, the definition includes only federal reserve banks, persons who are registered as "clearing agencies" under the federal securities laws (which impose a comprehensive system of regulation of the activities and rules of clearing agencies), and other entities subject to a comparable system of regulatory oversight.

6. "Communicate." The term "communicate" assures that the Article 8 rules will be sufficiently flexible adapt to changes in information technology. Sending a signed writing always suffices as a communication, but the parties can agree that a different means of transmitting information is to be used. Agreement is defined in Section 1-201(3) as "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade of course of performance." Thus, use of an information transmission method might be found to be authorized by agreement, even though the parties have not explicitly so specified in formal agreement. The term communicate is used in Sections 8-102(a)(8) (definition of entitlement order), 8-102(a)(12) (definition of instruction), and 8-403 (demand that issuer not register transfer).

7. "Entitlement holder." this term designates those who hold financial assets through intermediaries in the indirect holding system. Because many of the rules of Part 5 impose duties on securities intermediaries in favor of entitlement holders, the definition of entitlement holder is, in most cases, limited to the person specifically designated as such on the records of the intermediary. The last sentence of the definition covers the relatively unusual cases where a person may acquire a security entitlement under Section 8-501 even though the person may not be specifically designated as an entitlement holder on the records of the securities intermediary.

A person may have an interest in a security entitlement, and may even have the right to give entitlement orders to the securities intermediary with respect to it, even though the person is not the entitlement holder. For example, a person who holds securities through a securities account in its own name may have given discretionary trading authority to another person, such as an investment adviser. Similarly, the control provisions in Section 8-106 and the related provisions in Article 9 are designed to facilitate transactions in which a person who holds securities through a securities account uses them as collateral in an arrangement where the securities intermediary has agreed that if the secured party so directs the intermediary will dispose of the position. In such arrangements, the debtor remains the entitlement holder but has agreed that the secured party can initiate entitlement orders.

8. "Entitlement orders." The term is defined as a notification communicated to a securities intermediary directing transfer or redemption of the financial asset to which an entitlement holder has a security entitlement. The term is used in the rules for the indirect holding system in a fashion analogous to the use of the terms "indorsement" and "instruction" in the rules for the direct holding. If a person directly holds a certificated security in registered form and wishes to transfer it, the means of transfer is an indorsement. If a person directly holds an uncertificated security and wishes to transfer it, the means of transfer is an instruction. If a person holds a security entitlement, the means of disposition is an entitlement order. As noted in Comment 7, an entitlement order need not be initiated by the entitlement holder in

order to be effective, so long as the entitlement holder has authorized the other party to initiate entitlement orders. See Section 8-107(b).

9. "Financial asset." The definition of "financial asset," in conjunction with the definition of "security account" in Section 8-501, sets the scope of the indirect holding system rules of Part 5 of Revised Article 8. The Part 5 rules apply not only to securities held through intermediaries, but also to other financial assets held through intermediaries. The term financial asset is defined to include not only securities but also a broader category of obligations, shares, participations, and interests.

Having separate definitions of security and financial asset makes it possible to separate the question of the proper scope of the traditional Article 8 rules from the question of the proper scope of the new indirect holding system rules. Some forms of financial assets should be covered by the indirect holding system rules of Part 5, but not by the rules of Parts 2, 3, and 4. The term financial asset is used to cover such property. Because the term security entitlement is defined in terms of financial assets rather than securities, the rules concerning security entitlements set out in Part 5 of Article 8 in Revised Article 9 apply.to the broader class of financial assets.

The fact that something does or could fall within the definition of financial assets does not, without more, trigger Article 8 coverage. The indirect holding system rules of Revised Article 8 apply only if the financial asset is in fact held in a securities account, so that the interest of the person who holds the financial asset through the securities account is a security entitlement. Thus, question of the scope of the indirect holding system rules cannot be framed as "Is such-and-such a 'financial asset' under Article 8?" Rather, one must analyze whether relationship between an institution and a person on whose behalf the institution holds an asset falls within the scope of the term securities account as defined in Section 8-501. That question turns in large measure on whether it makes sense to apply the Part 5 rules to the relationship.

The term financial asset is used to refer both to the underlying asset and the particular means by which ownership is evidenced. Thus, with respect to a certificated security, the term financial asset may, as context requires, refer either to the interest or obligation of the issuer or to the security certificate representing that interest or obligation. Similarly, if a person holds a security or other financial asset through a securities account, the term financial asset may, as context requires, refer either to the underlying asset or to the person's security entitlement.

10. "Good faith." Good faith is defined in Article 8 for purposes of the application Article 8 of Section 10-203, which provides that "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." The sole function of the good faith definition in Revised Article 8 is to give content to the Section 1-203 obligation as it applies to contract and duties that are governed by Article 8. The standard is one of "reasonable commercial standards of fair dealing." The reference to commercial standards makes clear that assessments of conduct are to be made in light of the commercial setting. The substantive rules of Article 8 have been drafted to take account of the commercial circumstances of the securities holding and processing system. For example, Section 8-115 provides that a securities intermediary acting on an effective entitlement order, or a broker or other agent acting as a conduit in a securities transaction, is not liable to an adverse claimant, unless the claimant obtained legal process or the intermediary acted in collusion with the wrongdoer. This, and other similar provisions, see Sections 8-404 and 8-503(e), do not depend on notice of adverse claims, because it would impair rather than advance the interest of investors in having a sound and efficient securities clearance and settlement system to require intermediaries to investigate the propriety of the transactions they are processing. The good faith obligation does not supplant the standards of conduct established in provisions of this kind.

In Revised Article 8, the definition of good faith is not germane to the question whether a purchaser takes free from adverse claims. The rules on such questions as whether a purchaser who takes in suspicious circumstances is disqualified from protected purchaser status are treated not as an aspect of good faith but directly in the rules of Section 8-105 on notice of adverse claims.

11. "Indorsement" is defined as a signature made on a security certificate or separate document for purposes of transferring or redeeming the security. The definition is adapted from the language

of Section 8-308(1) of the prior version and from the definition of indorsement in the Negotiable Instruments Article, see Section 3-204(a). The definition of indorsement does not include the requirement that the signature be made by an appropriate person or be authorized. Those questions are treated in the separate substantive provision on whether the indorsement is effective, rather than in the definition of indorsement. See Section 8-107.

12. "Instruction" is defined as a notification communicated to the issuer of an uncertificated security directing that transfer be registered or that the security be redeemed. Instructions are the analog for uncertificated securities of indorsements of certificated securities.

13. "Registered form." The definition of "registered form" is substantially the same as in the prior version of Article 8. Like the definition of bearer form, it serves primarily to distinguish Article 8 securities from instruments governed by other law, such as Article 3.

14. "Securities intermediary." A "securities intermediary" is a person that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity. The most common examples of securities intermediaries would be clearing corporations holding securities for their participants, banks acting as securities custodians, and brokers holding securities on behalf of their customers. Clearing corporations are listed separately as a category of securities intermediary in subparagraph (i) even though in most circumstances they would fall within the general definition in subparagraph (ii). The reason is to simplify the analysis of arrangements such as the NSCC-DTC system in which NSCC performs the comparison, clearance, and netting functions while DTC acts as the depository. Because NSCC is a registered clearing agency under the federal securities laws, it is a clearing corporation and hence a securities intermediary under Article 8, regardless of whether it is at any particular time or in any particular aspect of its operations holding securities on behalf of its participants.

The terms securities intermediary and broker have different meanings. Broker means a person engaged in the business of buying and selling securities, as agent for others or as principal. Securities intermediary means a person maintaining securities accounts for others. A stockbroker, in the colloquial sense, may or may not be acting as a securities intermediary.

The definition of securities intermediary includes the requirement that the person in question is "acting to the capacity" of maintaining securities accounts for others. This is to take account of the fact that a particular entity, such as a bank, may act in many different capacities in securities transactions. A bank may act as a transfer agent for issuers, as a securities custodian for institutional investors and private investors, as a dealer in government securities, as a lender taking securities as collateral, and as a provider of general payment and collection services that might be used in connection with securities transactions. A bank that maintains securities accounts for its customers would be a securities intermediary with respect to those accounts; but if it takes a pledge of securities from a borrower to secure a loan, it is not thereby acting as a securities intermediary with respect to the pledge securities, since it holds them for its own account rather than for a customer. In other circumstances, those two functions might be combined. For example, if the bank is a government securities dealer it may maintain securities accounts for customers and also provide the customers with margin credit to purchase or carry the securities, in much the same way that broker provide margin loans to their customer.

15. "Security." The definition of "security" has three components. First, there is the subparagraph (i) test that the interest or obligation be fully transferable, in the sense that the issuer either maintains transfer books or the obligation or interest is represented by a certificate in bearer or registered form. Second, there is the subparagraph (ii) test that the interest or obligation be divisible, that is, one of a class or series, as distinguished from individual obligations of the sort governed by the ordinary contract law or by Article 3. Third, there is the subparagraph (iii) functional test, which generally turns on whether the interest or obligation is, or is of a type, dealt in or traded on securities markets or securities exchanges. There is, however, an "opt-in" provision in subparagraph (iii) which permits the issuer of any interest or obligation that is "a medium of investment" to specify that it is a security governed by Article 8.

The divisibility test of subparagraph (ii) applies to the security — that is, the underlying intangible interest not the means by which that interest is evidenced. Thus, securities issued in book-entry only form meet the divisibility test because the underlying intangible interest in divisible via the mechanism of the indirect holding system. This is so even though the clearing corporation is the only eligible direct holder of the security.

The third component, the functional test in subparagraph (iii), provides flexibility while ensuring that the Article 8 rules do not apply to interests or obligations in circumstances so unconnected with the securities markets that parties are unlikely to have thought of the possible that Article 8 might apply. Subparagraph (iii)(A) covers interests or obligations that either are dealt in or traded on securities exchanges or securities markets, or are of a type dealt in or traded on securities exchanges or securities markets. The "is dealt in or traded on" phrase eliminates problems in the characterization of new forms of securities which are to be traded in the markets, even though no similar type has previously been dealt in or traded in the markets. Subparagraph (iii)(B) covers the broader category of media for investment, but it applies only if the terms of the interest or obligation specify that it is an Article 8 security. This opt-in provision allows for deliberate expansion of the scope of Article 8.

Section 8-103 contains additional rules on the treatment of particular interests as securities or financial assets.

16. "Security certificate." The term "security" refers to the underlying asset, e.g., 1000 shares of common stock of Acme, Inc. The term "security certificate" refers to the paper certificates that have traditionally been used to embody the underlying intangible interest.

17. "Security entitlement" means the rights and property interest of a person who holds securities or other financial assets through a securities intermediary. A security entitlement is both a package of personal rights against the securities intermediary and an interest in the property held by the securities intermediary. A security entitlement is not, however, a specific property interest in any financial asset held by the securities intermediary or by the clearing corporation through which the securities intermediary holds the financial asset. See Section 8-104(c) and 8-503. The formal definition of security entitlement set out in subsection (a)(17) of this section is a cross-reference to the rules of Part 5. In a sense, then, the entirety of Part 5 is the definition of security entitlement. The Part 5 rules specify the rights and property interest that comprise a security entitlement.

18. "Uncertificated security." The term "uncertificated security" means a security that is not represented by a security certificate. For uncertificated securities, there is no need to draw any distinction between the underlying asset and the means by which a direct holder's interest in that asset is evidenced. Compare "certificated security" and "security certificate."

Definitional Cross References:

"Agreement"	Section 1-201(3).
"Bank"	Section 1-201(4).
"Person"	Section 8-201(30).
"Send"	Section 1-201(38).
"Signed"	Section 1-201(39).
"Writing"	Section 1-201(46).

CASE NOTES

Editor's Note. — *The cases below were decided under this Article of the Uniform Commercial Code prior to its 1997 revision.*

Shares of Close Corporation Securities. — Shares of stock in closely held corporation were investment "securities" under the definition of that term in former subdivision (1)(a) of this section. Stancil v. Stancil, 326 N.C. 766, 392 S.E.2d 373 (1990).

§ 25-8-103. Rules for determining whether certain obligations and interests are securities or financial assets.

(a) A share of [or] similar equity interest issued by a corporation, business trust, joint stock company, or similar entity is a security.

(b) An "investment company security" is a security. "Investment company security" means a share or similar equity interest issued by an entity that is registered as an investment company under the federal investment company laws, an interest in a unit investment trust that is so registered, or a face-amount certificate issued by a face-amount certificate company that is so registered. Investment company security does not include an insurance policy or endowment policy or annuity contract issued by an insurance company.

(c) An interest in a partnership or limited liability company is not a security unless it is dealt in or traded on securities exchanges or in securities markets, its terms expressly provide that it is a security governed by this Article, or it is an investment company security. However, an interest in a partnership or limited liability company is a financial asset if it is held in a securities account.

(d) A writing that is a security certificate is governed by this Article and not by Article 3 of this Chapter, even though it also meets the requirements of that Article. However, a negotiable instrument governed by Article 3 is a financial asset if it is held in a securities account.

(e) An option or similar obligation issued by a clearing corporation to its participants is not a security, but is a financial asset.

(f) A commodity contract, as defined in G.S. 25-9-115, is not a security or financial asset. (1941, c. 353, s. 15; G.S., s. 55-95; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. This section contains rules that supplement the definitions of "financial asset" and "security" in Section 8-102. The Section 8-102 definitions are worded in general terms, because they must be sufficiently comprehensive and flexible to cover the wide variety of investment products that now exist or may develop. The rules in this section are intended to foreclose interpretive issues concerning the application of the general definitions to several specific investment products. No implication is made about the application of the Section 8-102 definitions to investment products not covered by this section.

2. Subsection (a) establishes an unconditional rule that ordinary corporate stock is a security. That is so whether or not the particular issue is dealt in or traded or securities exchanges or in securities exchanges or in securities markets. Thus, shares of closely held are Article 8 securities.

3. Subsection (b) establishes that the Article 8 term "security" includes the various forms of the investment vehicles offered to the public by investment companies registered as such under the federal Investment Company Act of 1940, as amended. This clarification is prompted principally by the fact that the typical transaction in shares of open-end investment companies is an issuance of redemption, rather than a transfer of shares from one person to another as is the case with ordinary corporate stock. For similar reasons, the definitions of indorsement, instruction, and entitlement order in Section 8-102 refer to "redemptions" as well as "transfers," to ensure that the Article 8 rules on such matters as signature guaranties, Section 8-306, assurances, Sections 8-402 and 8-507, and effectiveness, Section 8-107, apply to directions to redeem mutual fund shares. The exclusion of insurance products is needed because some insurance company separate accounts are registered under the Investment Company Act of 1940, but these are not traded under the usual Article 8 mechanics.

4. Subsection (c) is designed to foreclose interpretive questions that might otherwise be raised by the application of the "of a type" language of Section 8-102(a)(15)(iii) to partnership interests. Subsection (c) establishes the general rule that partnership interests or shares of limited liability companies are not Article 8 securities unless they are in fact dealt in or traded on securities exchanges or in securities markets. The issuer, however, may explicitly "opt-in" by specifying that the interests or shares are securities governed by Article 8. Partnership interests or shares of limited liability companies are included by the broader term "financial asset." Thus, they are held through a securities ac-

count, the indirect holding system rules of Part 5 apply, and the interest of a person who hold them through such an account in a security entitlement.

5. Subsection (d) deals with the line between Article negotiable instruments and Article 8 investment securities. It continues the rule of the prior version of Article 8 that a writing that meets the Article 8 definition is covered by Article 8 rather than Article 3, even though it also meets the definition of negotiable instrument. However, subsection (d) provides that an Article 3 negotiable instrument is a "financial asset" so that the indirect holding system rules applies if the instrument is held through a securities intermediary. This facilitates making items such as money market instruments eligible for deposit in clearing corporations.

6. Subsection (e) is included to clarify the treatment of investment products such as traded stock options, which are treated as financial assets but not securities. Thus, the indirect holding system rules of Part 5 apply, but the direct holding system rules of Parts 2, 3, and 4 do not.

7. Subsection (f) excludes commodity contracts from all of Article 8. However, the Article 9 rules on security interest in investment property do apply to security interests in commodity positions. See Section 9-115 and Comment 8 thereto. "Commodity contract" is defined in Section 9-115.

Definitional Cross References:

"Clearing corporation" Section 8-102(a)(5).

"Commodity contract" Section 9-115.

"Financial asset" Section 8-102(a)(9).

"Security" Section 8-102(a)(15).

"Security certificate" Section 8-102(a)(16).

Editor's Note. — The bracketed word "or" was inserted in subsection (a) at the direction of the Revisor of Statutes to correct an apparent error.

§ 25-8-104. Acquisition of security or financial asset or interest therein.

(a) A person acquires a security or an interest therein, under this Article, if:

(1) The person is a purchaser to whom a security is delivered pursuant to G.S. 25-8-301; or

(2) The person acquires a security entitlement to the security pursuant to G.S. 25-8-501.

(b) A person acquires a financial asset, other than a security, or an interest therein, under this Article, if the person acquires a security entitlement to the financial asset.

(c) A person who acquires a security entitlement to a security or other financial asset has the rights specified in Part 5 of this Article, but is a purchaser of any security, security entitlement, or other financial asset held by the securities intermediary only to the extent provided in G.S. 25-8-503.

(d) Unless the context shows that a different meaning is intended, a person who is required by other law, regulation, rule, or agreement to transfer, deliver, present, surrender, exchange, or otherwise put in the possession of another person a security or financial asset satisfies that requirement by causing the other person to acquire an interest in the security or financial asset pursuant to subsection (a) or (b) of this section. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. This section lists the ways in which interests in securities and other financial assets are acquired under Article 8. In that sense, it describes the scope of Arti-

cle 8. Subsection (a) describes the two ways that a person may acquire a security or interest therein under this Article: (1) By delivery (Section 8-301), and (2) by acquiring a security entitlement. Each of these methods is described in detail in the relevant substantive provisions of this Article. Part 3, beginning with the definition of "delivery" in Section 8-301, describes how interests in securities are acquired in the direct holding system. Part 5, beginning with the rules of Section 8-501 on how security entitlements are acquired, describes how interests in securities are acquired in the indirect holding system.

Subsection (b) specifies how a person may acquire an interest under Article 8 in a financial asset other than a security. This Article deals with financial assets other than securities only insofar as they are held in the indirect holding system. For example, a bankers' acceptance falls within the definition of "financial asset," so if it is held through a securities account the entitlement holder's right to it is a security entitlement governed by Part 5. The bankers' acceptance itself, however, is a negotiable instrument governed by Article 3, not by Article 8. Thus, the provisions of Parts 2, 3, and 4 of this Article that deal with the rights of direct holders of securities are not applicable. Article 3, not Article 8, specifies how one acquires a direct interest in a bankers' acceptance. If a bankers' acceptance is delivered to a clearing corporation to be held for the account of the clearing corporation's participants, the clearing corporation becomes the holder of the bankers' acceptance under the Article 3 rules specifying how negotiable instruments are transferred. The rights of the clearing corporation's participants, however, are governed by Part 5 of this Article.

2. The distinction in usage in Article 8 between the term "security" (and its correlatives "security certificate" and "uncertificated security") on the one hand, and "security entitlement" on the other, corresponds to the distinction between the direct and indirect holding systems. For example, with respect to certificated securities that can be held either directly or through intermediaries, obtaining possession of a security certificate and acquiring a security entitlement are both means of holding the underlying security. For many other purposes, there is no need to draw a distinction between the means of holding. For purposes of commercial law analysis, however, the form of holding may make a difference. Where an item of property can be held in different ways, the rules on how one deals with it, including how one transfers it or how one grants a security interest in it, differ depending on the form of holding.

Although a security entitlement is means of holding the underlying security or other financial asset, a person who has a security entitlement does not have any direct claim to a specific asset in the possession of the securities intermediary. Subsection (c) provides explicitly that a person who acquires a security entitlement is a "purchaser" of any security, security entitlement, or other financial asset held by the securities intermediary only in the sense that under Section 8-503 a security entitlement is treated as a sui generis form of property interest.

3. Subsection (d) is designed to ensure that parties will retain their expected legal rights and duties under Revised Article 8. One of the major changes made by the revision is that the rules for the indirect holding system are stated in terms of the "security entitlements" held by investors, rather than speaking of them as holding direct interests in securities. Subsection (d) is designed as a translation rule to eliminate problems of co-ordination of terminology, and facilitate the continued use of systems for the efficient handling of securities and financial assets through securities intermediaries and clearing corporations. The efficiencies of a securities intermediary or clearing corporation are, in part, dependent on the ability to transfer securities credited to securities accounts in the intermediary or clearing corporation to the account of an issuer, its agent, or other person by book entry in a manner that permits exchanges, redemptions, conversions, and other transactions (which may be governed by pre-existing or new agreements, constitutional documents, or other instruments) to occur and to avoid the need to withdraw from immobilization in an intermediary or clearing corporation physical securities in order to deliver them for such purposes. Existing corporate charters, indentures, and like documents may require the "presentation," "surrender," "delivery," or "transfer" of securities or security certificates for purposes of exchange, redemption, conversion, or other reason. Likewise, documents may use a wide variety of terminology to describe, in the context for example of a tender or exchange offer, the means of putting the offeror or the issuer or its agent in possession of the security. Subsection (d)

takes the place of provisions of prior law which could be used to reach the legal conclusion that book-entry transfers are equivalent to physical delivery to the person to whose account the book entry is credited.

Definitional Cross References:

"Delivery"	Section 8-301.
"Financial asset"	Section 8-102(a)(9).
"Person"	Section 1-201(30).
"Purchaser"	Section 1-201(33) & 8-116.
"Security"	Section 8-102(a)(15).
"Security entitlement"	Section 8-102(a)(17).

§ 25-8-105. Notice of adverse claim.

(a) A person has notice of an adverse claim if:

(1) The person knows of the adverse claim;

(2) The person is aware of facts sufficient to indicate that there is a significant probability that the adverse claim exists and deliberately avoids information that would establish the existence of the adverse claim; or

(3) The person has a duty, imposed by statute or regulation, to investigate whether an adverse claim exists, and the investigation so required would establish the existence of the adverse claim.

(b) Having knowledge that a financial asset or interest therein is or has been transferred by a representative imposes no duty of inquiry into the rightfulness of a transaction and is not notice of an adverse claim. However, a person who knows that a representative has transferred a financial asset or interest therein in a transaction that is, or whose proceeds are being used, for the individual benefit of the representative or otherwise in breach of duty has notice of an adverse claim.

(c) An act or event that creates a right to immediate performance of the principal obligation represented by a security certificate or sets a date on or after which the certificate is to be presented or surrendered for redemption or exchange does not itself constitute notice of an adverse claim except in the case of a transfer more than:

(1) One year after a date set for presentment or surrender for redemption or exchange; or

(2) Six months after a date set for payment of money against presentation or surrender of the certificate if money was available for payment on that date.

(d) A purchaser of a certificated security has notice of an adverse claim if the security certificate:

(1) Whether in bearer or registered form, has been indorsed "for collection" or "for surrender" or for some other purpose not involving transfer; or

(2) Is in bearer form and has on it an unambiguous statement that it is the property of a person other than the transferor, but the mere writing of a name on the certificate is not such a statement.

(e) Filing of a financing statement under Article 9 of this Chapter is not notice of an adverse claim to a financial asset. (1965, c. 700; s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. The rules specifying whether adverse claims can be asserted against persons who acquire securities or security entitlements, Sections 8-303, 8-502, and 8-510, provide that one is protected against an adverse claim only if one

takes without notice of the claim. This section defines notice of an adverse claim.

The general Article 1 definition of "notice" in Section 1-201(25) — which provides that a person has notice of a fact if "from all the facts and circumstances known to him or her at the time in question he or she has reason to know that it exists" — does not apply to the interpretation of "notice of adverse claims." The Section 1-201(25) definition of "notice" does, however, apply to usages of that term and its cognates in Article 8 in contexts other than notice of adverse claims.

2. This section must be interpreted in light of the definition of "adverse claim" in Section 8-102(a)(1). "Adverse claim" does not include all circumstances in which a third party has a property interest in securities, but only those situations where a security is transferred in violation of the claimant's property interest. Therefor, awareness that someone other than the transferor has a property interest is not notice of an adverse claim. The transferee must be aware that the transfer violates the other party's property interest. If A holds securities in which B has some form of property interest, and A transfers the securities to C, C may know that B has an interest, but infer that A is acting in accordance with A's obligations to B. The mere fact that C knew that B had a property interest does not mean that C had notice of an adverse claim. Whether C had notice of an adverse claim depends on whether C had sufficient awareness that A was acting in violation of B's property rights. The rule in subsection (b) is a particularization of this general principle.

3. Paragraph (a)(1) provides that a person has notice of an adverse claim if the person has knowledge of the adverse claim. Knowledge is defined in Section 1-201(25) as actual knowledge.

4. Paragraph (a)(2) provides that a person has notice of an adverse claim if the person is aware of a significant probability that an adverse claim exists and deliberately avoids information that might establish the existence of the adverse claim. This is intended to codify the "willful blindness" test that has been applied in such cases. See *May v. Chapman,* 16 M. & W. 355, 153 Eng. Rep. 1225 (1847); *Goodman v. Simonds,* 61 U.S. 343 (1857).

The first prong of the willful blindness test of paragraph (a)(2) turns on whether the person is aware facts sufficient to indicate that there is a significant probability that an adverse claim exists. The "awareness" aspect necessarily turns on the actor's state of mind. Whether facts known to a person make the person aware of a "significant probability" that an adverse claim exists turns on facts about the world and the conclusions that would be drawn from those facts, taking account of the experience and position of the person in question. A particular set of facts might indicate a significant probability of an adverse claim to a professional with considerable experience in the usual methods and procedures by which securities transactions are conducted, even though the same facts would not indicate a significant probability of an adverse claim to a nonprofessional.

The second prong of the willful blindness test of paragraph (a)(2) turns on whether the person "deliberately avoids information" that would establish the existence of the adverse claim. The test is the character of the person's response to the information the person has. The question is whether the person deliberately failed to seek further information because of concern that suspicions would be confirmed.

Application of the "deliberate avoidance" test to a transaction by an organization focuses on the knowledge and the actions of the individual or individuals conducting the transaction on behalf of the organization. Thus, an organization that purchases a security is not willfully blind to an adverse claim unless the officers or agents who conducted that purchase transaction are willfully blind to the adverse claim. Under the two prongs of the willful blindness test, the individual or individuals conducting a transaction must know of facts indicating a substantial probability that the adverse claim exists and deliberately fail to seek further information that might confirm or refute the indication. For this purpose, information known to individuals within an organization who are not conducting or aware of a transaction, but not forwarded to the individuals conducting the transaction, is not pertinent in determining whether the individuals conducting the transaction had knowledge of a substantial probability of the existence of the adverse claim. Cf. Section 1-201(27). An organization may also "deliberately avoid information" if it acts to preclude or inhibit transmission of pertinent information to those individuals responsible for the conduct of purchase transactions.

5. Paragraph (a)(3) provides that a person has notice of an adverse claim if the person would have learned of the adverse claim by conducting an investigation that is required by other statute or regulation. This rule applies only if there is some other statute or regulation that explicitly requires persons dealing with securities to conduct some investigation. The federal securities laws require that brokers and banks, in certain specified circumstances, check with a stolen securities registry to determine whether securities offered for sale or pledge have been reported as stolen. If securities that were listed as stolen in the registry are taken by an institution that failed to comply with requirement to check the registry, the institution would be held to have notice of the fact that they were stolen under paragraph (a)(3). Accordingly, the institution could not qualify as a protected purchaser under Section 8-303. The same result has been reached under the prior version of Article 8. See *First Nat'l Bank of Cicero v. Lewco Securities,* 860 F.2d 1407 (7th Cir. 1988).

6. Subsection (b) provides explicitly for some situations involving purchase from one described or identifiable as a representative. Knowledge of the existence of the representative relation is not enough in itself to constitute "notice of an adverse claim" that would disqualify the purchaser from protected purchaser status. A purchaser may take a security on the inference that the representative is acting properly. Knowledge that a security is being transferred to an individual account of the representative or that the proceeds of the transaction will be paid into that account is not sufficient to constitute "notice of an adverse claim," but knowledge that the proceeds will be applied to the personal indebtedness of the representative is. See *State Bank of Binghamton v. Bache,* 162 Misc. 128, 293 N.Y.S. 667 (1937).

7. Subsection (c) specifies whether a purchaser of a "stale" security is charged with notice of adverse claims, and therefor disqualified from protected purchaser status under Section 8-303. The fact of "staleness" is viewed as notice of certain defects after the lapse of stated periods, but the maturity of the security does not operate automatically to affect holders' rights. The periods of time here stated are shorter than those appearing in the provisions of this article on staleness as notice of defects or defenses of an issuer (Section 8-203) since a purchaser who takes a security after funds or other securities are available for its redemption has more reason to suspect claims of ownership than issuer's defenses. An owner will normally turn in a security rather than transfer it at such a time. Of itself, a default never constitutes notice of a possible adverse claim. To provide otherwise would not tend to drive defaulted securities home and would serve only to disrupt current financial markets where many defaulted securities are actively traded. Unpaid or overdue coupons attached to a bond do not bring it within the operation of this subsection, though they may be relevant under the general test of notice of adverse claims in subsection (a).

8. Subsection (d) provides the owner of a certificated security with a means of protection while a security certificate is being sent in for redemption or exchange. The owner may endorse it "for collection" or "for surrender," and this constitutes notice of the owner's claims, under subsection (d).

Definitional Cross References:

"Adverse claim"	Section 8-102(a)(1).
"Bearer form"	Section 8-102(a)(2).
"Certificated security"	Section 8-102(a)(4).
"Financial asset"	Section 8-102(a)(9).
"Knowledge"	Section 1-201(25).
"Person"	Section 1-201(30).
"Purchaser"	Sections 1-201(33) & 8-116.
"Registered form"	Section 8-102(a)(13).
"Representative"	Section 1-201(35).
"Security certificate"	Section 8-102(a)(16).

§ 25-8-106. Control.

(a) A purchaser has "control" of a certificated security in bearer form if the certificated security is delivered to the purchaser.

(b) A purchaser has "control" of a certificated security in registered form if the certificated security is delivered to the purchaser, and:

(1) The certificate is indorsed to the purchaser or in blank by an effective indorsement; or

(2) The certificate is registered in the name of the purchaser, upon original issue or registration of transfer by the issuer.

(c) A purchaser has "control" of an uncertificated security if:

(1) The uncertificated security is delivered to the purchaser; or

(2) The issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner.

(d) A purchaser has "control" of a security entitlement if:

(1) The purchaser becomes the entitlement holder; or

(2) The securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder.

(e) If an interest in a security entitlement is granted by the entitlement holder to the entitlement holder's own securities intermediary, the securities intermediary has control.

(f) A purchaser who has satisfied the requirements of subdivision (c) (2) or (d) (2) of this section has control even if the registered owner in the case of subdivision (c) (2) of this section or the entitlement holder in the case of subdivision (d) (2) of this section retains the right to make substitutions for the uncertificated security or security entitlement, to originate instructions or entitlement orders to the issuer or securities intermediary, or otherwise to deal with the uncertificated security or security entitlement.

(g) An issuer or a securities intermediary may not enter into an agreement of the kind described in subdivision (c) (2) or (d) (2) of this section without the consent of the registered owner or entitlement holder, but an issuer or a securities intermediary is not required to enter into such an agreement even though the registered owner or entitlement holder so directs. An issuer or securities intermediary that has entered into such an agreement is not required to confirm the existence of the agreement to another party unless requested to do so by the registered owner or entitlement holder. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. The concept of "control" plays a key role in various provisions dealing with the rights of purchasers, including secured parties. See Sections 8-303 (protected purchasers); 8-503(e) (purchasers from securities intermediaries); 8-510 (purchasers of security entitlements from entitlement holders); 9-115(4) (perfection of security interests); 9-115(5) (priorities among conflicting security interests).

Obtaining "control" means that the purchaser has taken whatever steps are necessary, given the manner in which the securities are held, to place itself in a position where it can have the securities sold, without further action by the owner.

2. Subsection (a) provides that a purchaser obtains "control" with respect to a certificated security in bearer form by taking "delivery," as defined in Section 8-301. Subsection (b) provides that a purchaser obtains "control" with respect to a certificated security in registered form by taking "delivery," as defined in Section 8-301, provided that the security certificate has been indorsed to the purchaser or in blank. Section 8-301 provides that delivery of a certificated security occurs when the purchaser obtains possession of the security certificate, or when an agent for the purchaser (other than a securities intermediary) either acquires possession or acknowledges that the agent holds for the purchaser.

3. Subsection (c) specifies the means by which a purchaser can obtain control over uncertificated securities which the transferor holds directly. Two mechanisms are possible.

Under subsection (c)(1), securities can be "delivered" to a purchaser. Section 8-301(b) provides that "delivery" of an uncertificated security occurs when the purchaser becomes the registered holder.

So far as the issuer is concerned, the purchaser would then be entitled to exercise all rights of ownership. See Section 8-207. As between the parties to a purchase transaction, however, the rights of the purchaser are determined by their contract. Cf. Section 9-202. Arrangements covered by this paragraph are analogous to arrangements in which bearer certificates are delivered to a secured party — so far as the issuer or any other parties are concerned, the secured party appears to be the outright owner, although it is in fact holding as collateral property that belongs to the debtor.

Under subsection (c)(2), a purchaser has control if the issuer has agreed to act on the instructions of the purchaser, even though the owner remains listed as the registered owner. The issuer, of course, would be acting wrongfully against the registered owner if it entered into such an agreement without the consent of the registered owner. Subsection (g) makes this point explicit. The subsection (c)(2) provision makes it possible for issuers to offer a service akin to the registered pledge device of the 1978 version of Article 8, without mandating that all issuers offer that service.

4. Subsection (d) specifies the means by which a purchaser can obtain control over a security entitlement. Two mechanisms are possible, analogous to those provided in subsection (c) for uncertificated securities. Under subsection (d)(1), a purchaser has control if it is the entitlement holder. This subsection would apply whether the purchaser holds through the same intermediary that the debtor used, or has the securities position transferred to its own intermediary.

Subsection (d)(2) provides that a purchaser has control if the securities intermediary has agreed to act on entitlement orders originated by the purchaser, even though the transferor remains listed as the entitlement holder. This section specifies only the minimum requirements that such an arrangement must meet to confer "control"; the details of the arrangement can be specified by agreement. The arrangement might cover all of the positions in a particular account or subaccount, or only specified positions. There is no requirement that the control party's right to give entitlement orders be exclusive. The arrangement might provide that only the control party can give entitlement orders, or that either the entitlement holder or the control party can give entitlement orders. See subsection (f).

The following examples illustrate the rules of subsection (d):

Example 1. Debtor grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha Bank also has an account with Able. Debtor instructs Able to transfer the shares to Alpha Bank, and Able does so. Alpha Bank has control of the 1000 shares under subsection (d)(1), because Alpha Bank is the entitlement holder.

Example 2. Debtor grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha Bank does not have an account with Able. Alpha Bank uses Beta Bank as its securities custodian. Debtor instructs Able to transfer the shares to Beta Bank, for the account of Alpha Bank, and Able does so. Alpha Bank has control of the 1000 shares under subsection (d)(1), because Alpha Bank is the entitlement holder.

Example 3. Debtor grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Debtor, Able, and Alpha Bank enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Alpha Bank also has the right to direct dispositions. Alpha Bank has control of the 1000 shares under subsection (d)(2).

Example 4. Able & Co., a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into Alpha Bank's account at Clearing Corporation. Alpha Bank has control of the 1000 shares under subsection (d)(1).

Example 5. Able & Co., a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Alpha Bank does not have an account with Clearing Corporation. It holds its securities through Beta Bank, which does have an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into Beta Bank's account at Clearing Corporation. Beta Bank credits the position to Alpha Bank's account with Beta Bank. Alpha Bank has control of the 1000 shares under subsection (d)(1).

Example 6. Able & Co. a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into a pledge account, pursuant to an agreement under which Able will continue to receive dividends, distributions, and the like, but Alpha Bank has the right to direct dispositions. Alpha Bank has control of the 1000 shares under subsection (d)(2).

Example 7. Able & Co. a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able, Alpha, and Clearing Corporation enter into an agreement under which Clearing Corporation will act on instructions from Alpha with respect to the XYZ Co. stock carried in Able's account, but Able will continue to receive dividends, distributions, and the like, and will also have the right to direct dispositions. Alpha Bank has control of the 1000 shares under subsection (d)(2).

Example 8. Able & Co. a securities dealer, holds a wide range of securities through its account at Clearing Corporation. Able enters into an arrangement with Alpha Bank pursuant to which Alpha provides financing to Able secured by securities identified as the collateral on lists provided by Able to Alpha on a daily or other periodic basis. Able, Alpha, and Clearing Corporation enter into an agreement under which Clearing Corporation agrees that if at any time Alpha directs Clearing Corporation to do so, Clearing Corporation will transfer any securities from Able's account at Alpha's instructions. Because Clearing Corporation has agreed to act on Alpha's instructions with respect to any securities carried in Able's account, at the moment that Alpha's security interest attaches to securities listed by Able, Alpha obtains control of those securities under subsection (d)(2). There is no requirement that Clearing Corporation be informed of which securities Able has pledged to Alpha.

5. For a purchaser to have "control" under subsection (c)(2) or (d)(2), it is essential that the issuer or securities intermediary, as the case may be, actually be a party to the agreement. If a debtor gives a secured party a power of attorney authorizing the secured party to act in the name of the debtor, but the issuer or securities intermediary does not specifically agree to this arrangement, the secured party does not have "control" within the meaning of subsection (c)(2) or (d)(2) because the issuer or securities intermediary is not a party to the agreement. The secured party does not have control under subsection (c)(1) or (d)(1) because, although the power of attorney might give the secured party authority to act on the debtor's behalf as an agent, the secured party has not actually become the registered owner or entitlement holder.

6. Subsection (e) provides that if an interest in a security entitlement is granted by an entitlement holder to the securities intermediary through which the security entitlement is maintained, the securities intermediary has control. A common transaction covered by this provision is a margin loan from a broker to its customer.

7. The term "control" is used in a particular defined sense. The requirements for obtaining control are set out in this section. The concept is not to be interpreted by reference to similar concepts in other bodies of law. In particular, the requirements for "possession" derived from the common law of pledge are not to be used as a basis for interpreting subsection (c)(2) or (d)(2). Those provisions are designed to supplant the concepts of "constructive possession" and the like. A principal purpose of the "control" concept is to eliminate the uncertainty and confusion that results from attempting to apply common law possession concepts to modern securities holding practices.

The key to the control concept is that the purchaser has the present ability to have the securities sold or transferred without further action by the transferor. There is no requirement that the powers held by the purchaser be exclusive. For example, in a secured lending arrangement, if the secured party wishes, it can allow the debtor to retain the right to make substitutions, or to direct the disposition of the uncertificated security or security entitlement. Subsection (f) is included to make clear the general point stated in subsection (c) that the test of control is whether the purchaser has obtained the requisite power, not whether the debtor has retained other powers. There is no implication that retention by the debtor of powers other than those mentioned in subsection (f) is inconsistent with the purchaser having control.

Definitional Cross References:

"Bearer form"	Section 8-102(a)(2).
"Certificated security"	Section 8-102(a)(4).
"Delivery"	Section 8-301.
"Effective"	Section 8-107.
"Entitlement holder"	Section 8-102(a)(7).
"Entitlement order"	Section 8-102(a)(8).
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Purchaser"	Section 1-201(33) & 8-116.
"Registered form"	Section 8-102(a)(13).
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-107. Whether indorsement, instruction, or entitlement order is effective.

(a) "Appropriate person" means:

(1) With respect to an indorsement, the person specified by a security certificate or by an effective special indorsement to be entitled to the security;

(2) With respect to an instruction, the registered owner of an uncertificated security;

(3) With respect to an entitlement order, the entitlement holder;

(4) If the person designated in subdivision (1), (2), or (3) of this subsection is deceased, the designated person's successor taking under other law or the designated person's personal representative acting for the estate of the decedent; or

(5) If the person designated in subdivision (1), (2), or (3) of this subsection lacks capacity, the designated person's guardian, conservator, or other similar representative who has power under other law to transfer the security or financial asset.

(b) An indorsement, instruction, or entitlement order is effective if:

(1) It is made by the appropriate person;

(2) It is made by a person who has power under the law of agency to transfer the security or financial asset on behalf of the appropriate person, including, in the case of an instruction or entitlement order, a person who has control under G.S. 25-8-106(c)(2) or (d)(2); or

(3) The appropriate person has ratified it or is otherwise precluded from asserting its ineffectiveness.

(c) An indorsement, instruction, or entitlement order made by a representative is effective even if:

(1) The representative has failed to comply with a controlling instrument or with the law of the state having jurisdiction of the representative relationship, including any law requiring the representative to obtain court approval of the transaction; or

(2) The representative's action in making the indorsement, instruction, or entitlement order or using the proceeds of the transaction is otherwise a breach of duty.

(d) If a security is registered in the name of or specially indorsed to a person described as a representative, or if a securities account is maintained in the name of a person described as a representative, an indorsement, instruction, or entitlement order made by the person is effective even though the person is no longer serving in the described capacity.

(e) Effectiveness of an indorsement, instruction, or entitlement order is determined as of the date the indorsement, instruction, or entitlement order is made, and an indorsement, instruction, or entitlement order does not become ineffective by reason of any later change of circumstances. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. This section defines two concepts, "appropriate person" and "effective." Effectiveness is a broader concept than appropriate person. For example, if a security or securities account is registered in the name of Mary Roe, Mary Roe is the "appropriate person," but an indorsement, instruction, or entitlement order made by John Doe is "effective" if, under agency or other law, Mary Roe is precluded from denying Doe's authority. Treating these two concepts separately facilitates statement of the rules of Article 8 that state the legal effect of an indorsement, instruction, or entitlement order. For example, a securities intermediary is protected against liability if it acts on an effective entitlement order, but has a duty to comply with an entitlement order only if it is originated by an appropriate person. See Sections 8-115 and 8-507.

One important application of the "effectiveness" concept is in the direct holding system rules on the rights of purchasers. A purchaser of a certificated security in registered form can qualify as a protected purchaser who takes free from adverse claims under Section 8-303 only if the purchaser obtains "control." Section 8-106 provides that a purchaser of a certificated security in registered form obtains control if there has been an "effective" indorsement.

2. Subsection (a) provides that the term "appropriate person" covers two categories: (1) the person who is actually designated as the person entitled to the security or security entitlement, and (2) the successor or legal representative of that person if that person has died or otherwise lacks capacity. Other law determines who has power to transfer a security on behalf of a person who lacks capacity. For example, if securities are registered in the name of more than one person and one of the designated persons dies, whether the survivor is the appropriate person depends on the form of tenancy. If the two were registered joint tenants with right of survivorship, the survivor would have that power under other law and thus would be the "appropriate person." If securities are registered in the name of an individual and the individual dies, the law of decedents' estates determines who has power to transfer the decedent's securities. That would ordinarily be the executor or administrator, but if a "small estate statute" permits a widow to transfer a decedent's securities without administration proceedings, she would be the appropriate person. If the registration of a security or a securities account contains a designation of a death beneficiary under the Uniform Transfer on Death Security Registration Act or comparable legislation, the designated beneficiary would, under that law, have power to transfer upon the person's death and so would be the appropriate person. Article 8 does not contain a list of such representatives, because any list is likely to become outdated by developments in other law.

3. Subsection (b) sets out the general rule that an indorsement, instruction, or entitlement order is effective if it is made by the appropriate person or by a person who has power to transfer under agency law or if the appropriate person is precluded from denying its effectiveness. The control rules in Section 8-106 provide for arrangements where a person who holds securities through a securities intermediary, or holds uncertificated securities directly, enters into a control agreement giving the secured party the right to initiate entitlement orders of instructions. Paragraph 2 of subsection (b) states explicitly that an entitlement order or instruction initiated by a person who has obtained such a control agreement is "effective."

Subsections (c), (d), and (e) supplement the general rule of subsection (b) on effectiveness. The term "representative," used in subsections (c) and (d), is defined in Section 1-201(35).

4. Subsection (c) provides that an indorsement, instruction, or entitlement order made by a representative is effective even though the representative's action is a violation of duties. The following example illustrates this subsection:

> *Example 1.* Certificated securities are registered in the name of John Doe. Doe dies and Mary Roe is appointed executor. Roe indorses the security certificate and transfers it to a purchaser in a transaction that is a violation of her duties as executor.

Roe's indorsement is effective, because Roe is the appropriate person under subsection (a)(4). This is so even though Roe's transfer violated her obligations as executor. The policies of free transferability of securities that underlie Article 8 dictate that neither a purchaser to whom Roe transfers the securities nor the issuer who registers transfer should be required to investigate the terms of the will to determine whether Roe is acting properly. Although Roe's indorsement is effective under this section, her breach of duty may be such that her beneficiary has an adverse claim to the securities that Roe transferred. The question whether that adverse claim can be asserted against purchasers is governed not by this section but by Section 8-303. Under Section 8-404, the issuer has no duties to an adverse claimant unless the claimant obtains legal process enjoining the issuer from registering transfer.

5. Subsection (d) deals with cases where a security or a securities account is registered in the name of a person specifically designated as a representative. The following example illustrates this subsection:

> *Example 2.* Certificated securities are registered in the name of "John Jones, trustee of the Smith Family Trust." John Jones is removed as trustee and Martha Moe is appointed successor trustee. The securities, however, are not reregistered, but remain registered in the name of "John Jones, trustee of the Smith Family Trust." Jones indorses the security certificate and transfers it to a purchaser.

Subsection (d) provides that an indorsement by John Jones as trustee is effective even though Jones is no longer serving in that capacity. Since the securities were registered in the name of "John Jones, trustee of the Smith Family Trust," a purchaser, or the issuer when called upon to register transfer, should be entitled to assume without further inquiry that Jones has the power to act as trustee for the Smith Family Trust.

Note that subsection (d) does not apply to a case where the security or securities account is registered in the name of principal rather than the representative as such. The following example illustrates this point:

> *Example 3.* Certificated securities are registered in the name of John Doe. John Doe dies and Mary Roe is appointed executor. The securities are not reregistered in the name of Mary Roe as executor. Later, Mary Roe is removed as executor and Martha Moe is appointed as her successor. After being removed, Mary Roe indorses the security certificate that is registered in the name of John Doe and transfers it to a purchaser.

Mary Roe's indorsement is not made effective by subsection (d), because the securities were not registered in the name of Mary Roe as representative. A purchaser or the issuer registering transfer should be required to determine whether Roe has power to act for John Doe. Purchasers and issuers can protect themselves in such cases by requiring signature guaranties. See Section 8-306.

6. Subsection (e) provides that the effectiveness of an indorsement, instruction, or entitlement order is determined as of the date it is made. The following example illustrates this subsection:

> *Example 4.* Certificated securities are registered in the name of John Doe. John Doe dies and Mary Roe is appointed executor. Mary Roe indorses the security certificate that is registered in the name of John Doe and transfers it to a purchaser. After the indorsement and transfer, but before the security certificate is presented to the issuer for registration of transfer, Mary Roe is removed as executor and Martha Moe is appointed as her successor.

Mary Roe's indorsement is effective, because at the time Roe indorsed she was the appropriate person under subsection (a)(4). Her later removal as executor does not render the indorsement ineffective. Accordingly, the issuer would not be liable for registering the transfer. See Section 8-404.

Definitional Cross References:

"Entitlement order" Section 8-102(a)(8).

"Financial asset"	Section 8-102(a)(9).
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Representative"	Section 1-201(35).
"Securities account"	Section 8-501.
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).
"Security entitlement"	Section 8-102(a)(17).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-108. Warranties in direct holding.

(a) A person who transfers a certificated security to a purchaser for value warrants to the purchaser, and an indorser, if the transfer is by indorsement, warrants to any subsequent purchaser, that:
(1) The certificate is genuine and has not been materially altered;
(2) The transferor or indorser does not know of any fact that might impair the validity of the security;
(3) There is no adverse claim to the security;
(4) The transfer does not violate any restriction on transfer;
(5) If the transfer is by indorsement, the indorsement is made by an appropriate person, or if the indorsement is by an agent, the agent has actual authority to act on behalf of the appropriate person; and
(6) The transfer is otherwise effective and rightful.

(b) A person who originates an instruction for registration of transfer of an uncertificated security to a purchaser for value warrants to the purchaser that:
(1) The instruction is made by an appropriate person, or if the instruction is by an agent, the agent has actual authority to act on behalf of the appropriate person;
(2) The security is valid;
(3) There is no adverse claim to the security; and
(4) At the time the instruction is presented to the issuer:
  (i) The purchaser will be entitled to the registration of transfer;
  (ii) The transfer will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction;
  (iii) The transfer will not violate any restriction on transfer; and
  (iv) The requested transfer will otherwise be effective and rightful.

(c) A person who transfers an uncertificated security to a purchaser for value and does not originate an instruction in connection with the transfer warrants that:
(1) The uncertificated security is valid;
(2) There is no adverse claim to the security;
(3) The transfer does not violate any restriction on transfer; and
(4) The transfer is otherwise effective and rightful.

(d) A person who indorses a security certificate warrants to the issuer that:
(1) There is no adverse claim to the security; and
(2) The indorsement is effective.

(e) A person who originates an instruction for registration of transfer of an uncertificated security warrants to the issuer that:
(1) The instruction is effective; and
(2) At the time the instruction is presented to the issuer the purchaser will be entitled to the registration of transfer.

(f) A person who presents a certificated security for registration of transfer or for payment or exchange warrants to the issuer that the person is entitled to the registration, payment, or exchange, but a purchaser for value and without notice of adverse claims to whom transfer is registered warrants only that the person has no knowledge of any unauthorized signature in a necessary indorsement.

(g) If a person acts as agent of another in delivering a certificated security to a purchaser, the identity of the principal was known to the person to whom the certificate was delivered, and the certificate delivered by the agent was received by the agent from the principal or received by the agent from another person at the direction of the principal, the person delivering the security certificate warrants only that the delivering person has authority to act for the principal and does not know of any adverse claim to the certificated security.

(h) A secured party who redelivers a security certificate received, or after payment and on order of the debtor delivers the security certificate to another person, makes only the warranties of an agent under subsection (g) of this section.

(i) Except as otherwise provided in subsection (g) of this section, a broker acting for a customer makes to the issuer and a purchaser the warranties provided in subsections (a) through (f) of this section. A broker that delivers a security certificate to its customer, or causes its customer to be registered as the owner of an uncertificated security, makes to the customer the warranties provided in subsection (a) or (b) of this section, and has the rights and privileges of a purchaser under this section. The warranties of and in favor of the broker acting as an agent are in addition to applicable warranties given by and in favor of the customer. (1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsections (a), (b), and (c) deal with warranties by security transferors to purchasers. Subsections (d) and (e) deal with warranties by security transferors to issuers. Subsection (f) deals with presentment warranties.

2. Subsection (a) specifies the warranties made by a person who transfers a certificated security to a purchaser for value. Paragraphs (3), (4), and (5) make explicit several key points that are implicit in the general warranty of paragraph (6) that the transfer is effective and rightful. Subsection (b) sets forth the warranties made to a purchaser for value by one who originates an instruction. These warranties are quite similar to those made by one transferring a certificated security, subsection (a), the principal difference being the absolute warranty of validity. If upon receipt of the instruction the issuer should dispute the validity of the security, the burden of proving validity is upon the transferor. Subsection (c) provides for the limited circumstances in which an uncertificated security could be transferred without an instruction, see Section 8-301(b)(2). Subsections (d) and (e) give the issuer the benefit of the warranties of an indorser or originator on those matters not within the issuer's knowledge.

3. Subsection (f) limits the warranties made by a purchaser for value without notice whose presentation of a security certificate is defective in some way but to whom the issuer does register transfer. The effect is to deny the issuer a remedy against such a person unless at the time of presentment the person had knowledge of an unauthorized signature in a necessary indorsement. The issuer can protect itself by refusing to make the transfer or, if it registers the transfer before it discovers the defect, by pursuing its remedy against a signature guarantor.

4. Subsection (g) eliminates all substantive warranties in the relatively unusual case of a delivery of certificated security by an agent of a disclosed principal where the agent delivers the exact certificate that it received from or for the principal. Subsection (h) limits the warranties given by a secured party who redelivers a certificate. Subsection (i)

specifies the warranties of brokers in the more common scenarios.

5. Under Section 1-102(3) the warranty provisions apply "unless otherwise agreed" and the parties may enter into express agreements to allocate the risks of possible defects. Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be breached in such a case.

Definitional Cross References:

"Adverse claim"	Section 8-102(a)(1).
"Appropriate person"	Section 8-107.
"Broker"	Section 8-102(a)(3).
"Certificated security"	Section 8-102(a)(4).
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.
"Person"	Section 1-201(30).
"Purchaser"	Sections 1-201(33) & 8-116.
"Secured party"	Section 9-105(1)(m).
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).
"Uncertificated security"	Section 8-102(a)(18).
"Value"	Sections 1-201(44) & 8-116.

§ 25-8-109. Warranties in indirect holding.

(a) A person who originates an entitlement order to a securities intermediary warrants to the securities intermediary that:

(1) The entitlement order is made by an appropriate person, or if the entitlement order is by an agent, the agent has actual authority to act on behalf of the appropriate person; and

(2) There is no adverse claim to the security entitlement.

(b) A person who delivers a security certificate to a securities intermediary for credit to a securities account or originates an instruction with respect to an uncertificated security directing that the uncertificated security be credited to a securities account makes to the securities intermediary the warranties specified in G.S. 25-8-108(a) or (b).

(c) If a securities intermediary delivers a security certificate to its entitlement holder or causes its entitlement holder to be registered as the owner of an uncertificated security, the securities intermediary makes to the entitlement holder the warranties specified in G.S. 25-8-108(a) or (b). (1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) provides that a person who originates an entitlement order warrants to the securities intermediary that the order is authorized, and warrants the absence of adverse claims. Subsection (b) specifies the warranties that are given when a person who holds securities directly has the holding converted into indirect form. A person who delivers a certificate to a securities intermediary or originates an instruction for an uncertificated security gives to the securities intermediary the transfer warranties under Section 8-108. If the securities intermediary in turns delivers the certificate to a higher level securities intermediary, it gives the same warranties.

2. Subsection (c) states the warranties that a securities intermediary gives when a customer who has been holding securities in an account with the securities intermediary requests that certificates be delivered or that uncertificated securities be registered in the customer's name. The warranties are the same as those that brokers make with respect to securities that the brokers sell to or buy on behalf of the customers. See Section 8-108(i).

3. As with the Section 8-108 warranties, the warranties specified in this section may be modified by agreement under Section 1-102(3).

Definitional Cross References:

"Adverse claim"	Section 8-102(a)(1).
"Appropriate person"	Section 8-107.
"Entitlement holder"	Section 8-102(a)(7).
"Entitlement order"	Section 8-102(a)(8).
"Instruction"	Section 8-102(a)(12).

"Person" Section 1-201(30).
"Securities account" Section 8-501.
"Securities intermediary" Section 8-102(a)(14).
"Security certificate" Section 8-102(a)(16).
"Uncertificated security" Section 8-102(a)(18).

§ 25-8-110. Applicability; choice of law.

(a) The local law of the issuer's jurisdiction, as specified in subsection (d) of this section, governs:

(1) The validity of a security;
(2) The rights and duties of the issuer with respect to registration of transfer;
(3) The effectiveness of registration of transfer by the issuer;
(4) Whether the issuer owes any duties to an adverse claimant to a security; and
(5) Whether an adverse claim can be asserted against a person to whom transfer of a certificated or uncertificated security is registered or a person who obtains control of an uncertificated security.

(b) The local law of the securities intermediary's jurisdiction, as specified in subsection (e) of this section, governs:

(1) Acquisition of a security entitlement from the securities intermediary;
(2) The rights and duties of the securities intermediary and entitlement holder arising out of a security entitlement;
(3) Whether the securities intermediary owes any duties to an adverse claimant to a security entitlement; and
(4) Whether an adverse claim can be asserted against a person who acquires a security entitlement from the securities intermediary or a person who purchases a security entitlement or interest therein from an entitlement holder.

(c) The local law of the jurisdiction in which a security certificate is located at the time of delivery governs whether an adverse claim can be asserted against a person to whom the security certificate is delivered.

(d) "Issuer's jurisdiction" means the jurisdiction under which the issuer of the security is organized or, if permitted by the law of that jurisdiction, the law of another jurisdiction specified by the issuer. An issuer organized under the law of this State may specify the law of another jurisdiction as the law governing the matters specified in subdivisions (a)(2) through (5) of this section.

(e) The following rules determine a "securities intermediary's jurisdiction" for purposes of this section:

(1) If an agreement between the securities intermediary and its entitlement holder specifies that it is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.
(2) If an agreement between the securities intermediary and its entitlement holder does not specify the governing law as provided in subdivision (1) of this subsection, but expressly specifies that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.
(3) If an agreement between the securities intermediary and its entitlement holder does not specify a jurisdiction as provided in subdivision (1) or (2) of this subsection, the securities intermediary's jurisdiction is the jurisdiction in

which is located the office identified in an account statement as the office serving the entitlement holder's account.

(4) If an agreement between the securities intermediary and its entitlement holder does not specify a jurisdiction as provided in subdivision (1) or (2) of this subsection and an account statement does not identify an office serving the entitlement holder's account as provided in subdivision (3) of this subsection, the securities intermediary's jurisdiction is the jurisdiction in which is located the chief executive office of the securities intermediary.

(f) A securities intermediary's jurisdiction is not determined by the physical location of certificates representing financial assets, or by the jurisdiction in which is organized the issuer of the financial asset with respect to which an entitlement holder has a security entitlement, or by the location of facilities for data processing or other record keeping concerning the account. (1997-181, s. 1.)

OFFICIAL COMMENT

1. This section deals with applicability and choice of law issues concerning Article 8. The distinction between the direct and indirect holding systems plays a significant role in determining the governing law. An investor in the direct holding system is registered on the books of the issuer and/or has possession of a security certificate. Accordingly, the jurisdiction of incorporation of the issuer or location of the certificate determine the applicable law. By contrast, an investor in the indirect holding system has a security entitlement, which is a bundle of rights against the securities intermediary with respect to a security, rather than a direct interest in the underlying security. Accordingly, in the rules for the indirect holding system, the jurisdiction of incorporation of the issuer of the underlying security or the location of any certificates that might be held by the intermediary or a higher tier intermediary, do not determine the applicable law.

The phrase "local law" refers to the law of a jurisdiction other than its conflict of laws rules. See Restatement (Second) of Conflict of Laws Section 4.

2. Subsection (a) provides that the law of an issuer's jurisdiction governs certain issues where the substantive rules of Article 8 determine the issuer's rights and duties. Paragraph (1) of subsection (a) provides that the law of the issuer's jurisdiction governs the validity of the security. This ensures that a single body of law will govern the questions addressed in Part 2 of Article 8, concerning the circumstances in which an issuer can and cannot assert invalidity as a defense against purchasers. Similarly, paragraphs (2), (3), and (4) of subsection (a) ensure that the issuer will be able to look to a single body of law on the questions addressed in Part 4 of Article 8, concerning the issuer's duties and liabilities with respect to registration of transfer.

Paragraph (5) of subsection (a) applies the law of an issuer's jurisdiction to the question whether an adverse claim can be asserted against a purchaser to whom transfer has been registered, or who has obtained control over an uncertificated security. Although this issue deals with the rights of persons other than the issuer, the law of the issuer's jurisdiction applies because the purchasers to whom the provision applies are those whose protection against adverse claims depends on the fact that their interests have been recorded on the books of the issuer.

The principal policy reflected in the choice of law rules in subsection (a) is that an issuer and others should be able to look to a single body of law on the matters specified in subsection (a), rather than having to look to the law of all of the different jurisdictions in which security holders may reside. The choice of law policies reflected in this subsection do not require that the body of law governing all of the matters specified in subsection (a) be that of the jurisdiction in which the issuer is incorporated. Thus, subsection (d) provides that the term "issuer's jurisdiction" means the jurisdiction in which the issuer is organized, or, if permitted by that law, the law of another jurisdiction selected by the issuer. Subsection (d) also provides that issuers organized under the law of a State which adopts this Article may make such a selection, except as to the validity issue specified in paragraph (1). The question whether an issuer can assert the defense of invalidity may implicate significant policies of the issuer's jurisdiction of incorporation. See, e.g., Section 8-202 and Comments thereto.

Although subsection (a) provides that the issuer's rights and duties concerning registration of transfer are governed by the law of the issuer's jurisdiction, other matters related to registration of transfer, such as appointment of a guardian for a registered owner or the existence of agency relationships, might be governed by another jurisdiction's law. Neither this section nor Section 1-105 deals with what law governs the appointment of the administrator or executor; that question is determined under generally applicable choice of law rules.

3. Subsection (b) provides that the law of the securities intermediary's jurisdiction governs the issues concerning the indirect holding system that are dealt with in Article 8. Paragraphs (1) and (2) cover the matters dealt with in the Article 8 rules defining the concept of security entitlement and specifying the duties of securities intermediaries. Paragraph (3) provides that the law of the security intermediary's jurisdiction determines whether the intermediary owes any duties to an adverse claimant. Paragraph (4) provides that the law of the security intermediary's jurisdiction determines whether adverse claims can be asserted against entitlement holders and others.

Subsection (e) determines what is a "securities intermediary's jurisdiction." The policy of subsection (b) is to ensure that a securities intermediary and all of its entitlement holders can look to a single, readily-identifiable body of law to determine their rights and duties. Accordingly, subsection (e) sets out a sequential series of tests to facilitate identification of that body of law. Paragraph (1) of subsection (e) permits specification of the governing law by agreement. Because the policy of this section is to enable parties to determine, in advance and with certainty, what law will apply to transactions governed by this Article, the validation of selection of governing law by agreement is not conditioned upon a determination that the jurisdiction whose law is chosen bear a "reasonable relation" to the transaction. See Section 4A-507; compare Section 1-105(1). That is also true with respect to the similar provisions in subsection (d) of this section and in Section 9-103(6).

Subsection (f) makes explicit a point that is implicit in the Article 8 description of a security entitlement as a bundle of rights against the intermediary with respect to a security or other financial asset, rather than as a direct interest in the underlying security or other financial asset. The governing law for relationships in the indirect holding system is not determined by such matters as the jurisdiction of incorporation of the issuer of the securities held through the intermediary, or the location of any physical certificates held by the intermediary or a higher tier intermediary.

4. Subsection (c) provides a choice of law rule for adverse claim issues that may arise in connection with delivery of security certificates in the direct holding system. It applies the law of the place of delivery. If a certificated security issued by an Idaho corporation is sold, and the sale is settled by physical delivery of the certificate from Seller to Buyer in New York, under subsection (c), New York law determines whether Buyer takes free from adverse claims. The domicile of Seller, Buyer, and any adverse claimant is irrelevant.

5. The following examples illustrate how a court in a jurisdiction which has enacted this section would determine the governing law:

Example 1. John Doe, a resident of Kansas, maintains a securities account with Able & Co. Able is incorporated in Delaware. Its chief executive offices are located in Illinois. The office where Doe transacts business with Able is located in Missouri. The agreement between Doe and Able specifies that it is governed by Illinois law. Through the account, Doe holds securities of a Colorado corporation, which Able holds through Clearing Corporation. The rules of Clearing Corporation provide that the rights and duties of Clearing Corporation and its participants are governed by New York law. Subsection (a) specifies that a controversy concerning the rights and duties as between the issuer and Clearing Corporation is governed by Colorado law. Subsections (b) and (e) specify that a controversy concerning the rights and duties as between the Clearing Corporation and Able is governed by New York law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Illinois law.

Example 2. Same facts as to Doe and Able as in example 1. Through the account, Doe holds securities of a Senegalese corporation, which Able holds through Clearing Corporation. Clearing Corporation's operations are located in Belgium, and its rules and agreements with its participants provide that they are governed by Belgian law. Clearing Corporation holds the securities through a custodial account at the Paris branch office of Global Bank, which is organized under English law. The agreement between Clearing Corporation and Global Bank provides that it is governed by French law. Subsection (a) specifies that a controversy concerning the rights and duties as between the issuer and Global Bank is governed by Senegalese law. Subsections (b) and (e) specify that a controversy concerning the rights and duties as between Global Bank and Clearing Corporation is governed by French law, that a controversy concerning the rights and duties as between Clearing Corporation and Able is governed by Belgian law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Illinois law.

6. To the extent that this section does not specify the governing law, general choice of law rules apply. For example, suppose that in either of the examples in the preceding Comment, Doe enters into an agreement with Roe, also a resident of Kansas, in which Doe agrees to transfer all of his interests in the securities held through Able to Roe. Article 8 does not deal with whether such an agreement is enforceable or whether it gives Roe some interest in Doe's security entitlement. This section specifies what jurisdiction's law governs the issues that are dealt with in Article 8. Article 8, however, does specify that securities intermediaries have only limited duties with respect to adverse claims. See Section 8-115. Subsection (b)(3) of this section provides that Illinois law governs whether Able owes any duties to an adverse claimant. Thus, if Illinois has adopted Revised Article 8, Section 8-115 as enacted in Illinois determines whether Roe has any rights against Able.

7. The choice of law provisions concerning security interests in securities and security entitlements are set out in Section 9-103(6).

Definitional Cross References:

"Adverse claim"	Section 8-102(a)(1).
"Agreement"	Section 1-201(3).
"Certificated security"	Section 8-102(a)(4).
"Entitlement holder"	Section 8-102(a)(7).
"Financial asset"	Section 8-102(a)(9).
"Issuer"	Section 8-201.
"Person"	Section 1-201(30).
"Purchase"	Section 1-201(32).
"Securities intermediary"	Section 8-102(a)(14).
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).
"Security entitlement"	Section 8-102(a)(17).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-111. Clearing corporation rules.

A rule adopted by a clearing corporation governing rights and obligations among the clearing corporation and its participants in the clearing corporation is effective even if the rule conflicts with this Article and affects another party who does not consent to the rule. (1997-181, s. 1.)

OFFICIAL COMMENT

1. The experience of the past few decades shows that securities holding and settlement practices may develop rapidly, and in unforeseeable directions. Accordingly, it is desirable that the rules of Article 8 be adaptable both to ensure that commercial law can conform to changing practices and to ensure that commercial law does not operate as an obstacle to developments in securities practice. Even if practices were unchanging, it would not be possible in a general statute to specify in detail the rules needed to provide certainty in the operations of the clearance and settlement system.

The provisions of this Article and Article 1 on the effect of agreements provide considerable flexibility in the specification of the details of the rights and obligations of participants in the securities holding system by agreement. See Sections 8-504 through 8-509, and Section 1-102(3) and (4). Given the magnitude of the exposures involved in securities transactions, however, it may not be possible for the parties in developing practices to rely solely on private agreements, particularly with respect to matters that might affect others, such as creditors. For example, in order to be fully effective, rules of clearing corporations on the finality or reversibility of securities settlements must not only bind the participants in the clearing corporation but also be effective against their creditors. Section 8-111 provides that clearing corporation rules are effective even if they indirectly affect third parties, such as creditors of a participant. This provision does not, however, permit rules to be adopted that would govern the rights and obligations of third parties other than as a consequence of rules that specify the rights and obligations of the clearing corporation and its participants.

2. The definition of clearing corporation in Section 8-102 covers only federal reserve banks, entities registered as clearing agencies under the federal securities laws, and others subject to comparable regulation. The rules of registered clearing agencies are subject to regulatory oversight under the federal securities laws.

Definitional Cross References:

"Clearing corporation" Section 8-102(a)(5).

§ 25-8-112. Creditor's legal process.

(a) The interest of a debtor in a certificated security may be reached by a creditor only by actual seizure of the security certificate by the officer making the attachment or levy, except as otherwise provided in subsection (d) of this section. However, a certificated security for which the certificate has been surrendered to the issuer may be reached by a creditor by legal process upon the issuer.

(b) The interest of a debtor in an uncertificated security may be reached by a creditor only by legal process upon the issuer at its chief executive office in the United States, except as otherwise provided in subsection (d) of this section.

(c) The interest of a debtor in a security entitlement may be reached by a creditor only by legal process upon the securities intermediary with whom the debtor's securities account is maintained, except as otherwise provided in subsection (d) of this section.

(d) The interest of a debtor in a certificated security for which the certificate is in the possession of a secured party, or in an uncertificated security registered in the name of a secured party, or a security entitlement maintained in the name of a secured party, may be reached by a creditor by legal process upon the secured party.

(e) A creditor whose debtor is the owner of a certificated security, uncertificated security, or security entitlement is entitled to aid from a court of competent jurisdiction, by injunction or otherwise, in reaching the certificated security, uncertificated security, or security entitlement or in satisfying the claim by means allowed at law or in equity in regard to property that cannot readily be reached by other legal process. (1997-181, s. 1.)

OFFICIAL COMMENT

1. In dealing with certificated securities the instrument itself is the vital thing, and therefor a valid levy cannot be made unless all possibility of the certificate's wrongfully finding its way into a transferee's hands has been removed. This can be accomplished only when the certificate is in the possession of a public officer, the issuer, or an independent third party. A debtor who has been enjoined can still transfer the security in contempt of court. See *Overlock v. Jerome-Portland Copper Mining Co.*, 29 Ariz. 560, 243 P. 400 (1926). Therefor, although injunctive relief is provided in subsection (e) so that creditors may use

this method to gain control of the certificated security, the security certificate itself must be reached to constitute a proper levy whenever the debtor has possession.

2. Subsection (b) provides that when the security is uncertificated and registered in the debtor's name, the debtor's interest can be reached only by legal process upon the issuer. The most logical place to serve the issuer would be the place where the transfer records are maintained, but that location might be difficult to identify, especially when the separate elements of a computer network might be situated in different places. The chief executive office is selected as the appropriate place by analogy to Section 9-103(3)(d). See Comment 5(c) to that section. This section indicates only how attachment is to be made, not when it is legally justified. For that reason there is no conflict between this section and *Shaffer v. Heitner,* 433 U.S. 186 (1977).

3. Subsection (c) provides that a security entitlement can be reached only by legal process upon the debtor's security intermediary. Process is effective only if directed to the debtor's own security intermediary. If Debtor holds securities through Broker, and Broker in turn holds through Clearing Corporation, Debtor's property interest is a security entitlement against Broker. Accordingly, Debtor's creditor cannot reach Debtor's interest by legal process directed to the Clearing Corporation. See also Section 8-115.

4. Subsection (d) provides that when a certificated security, an uncertificated security, or a security entitlement is controlled by a secured party, the debtor's interest can be reached by legal process upon the secured party. This section does not attempt to provide for rights as between the creditor and the secured party, as, for example, whether or when the secured party must liquidate the security.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Issuer"	Section 8-201.
"Secured party"	Section 9-105(1)(m).
"Securities intermediary"	Section 8-102(a)(14).
"Security certificate"	Section 8-102(a)(16).
"Security entitlement"	Section 8-102(a)(17).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-113. Statute of frauds inapplicable.

A contract or modification of a contract for the sale or purchase of a security is enforceable whether or not there is a writing signed or record authenticated by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one year of its making. (1997-181, s. 1.)

OFFICIAL COMMENT

This section provides that the statute of frauds does not apply to contracts for the sale of securities, reversing prior law which had a special statute of frauds in Section 8-319 (1978). With the increasing use of electronic means of communication, the statute of frauds is unsuited to the realities of the securities business. For securities transactions, whatever benefits a statute of frauds may play in filtering out fraudulent claims are outweighed by the obstacles it places in the development of modern commercial practices in the securities business.

Definitional Cross References:

"Action"	Section 1-201(1).
"Contract"	Section 1-201(11).
"Writing"	Section 1-201(46).

§ 25-8-114. Evidentiary rules concerning certificated securities.

The following rules apply in an action on a certificated security against the issuer:

(1) Unless specifically denied in the pleadings, each signature on a security certificate or in a necessary indorsement is admitted.

(2) If the effectiveness of a signature is put in issue, the burden of establishing effectiveness is on the party claiming under the signature, but the signature is presumed to be genuine or authorized.

(3) If signatures on a security certificate are admitted or established, production of the certificate entitles a holder to recover on it unless the defendant establishes a defense or a defect going to the validity of the security.

(4) If it is shown that a defense or defect exists, the plaintiff has the burden of establishing that the plaintiff or some person under whom the plaintiff claims is a person against whom the defense or defect cannot be asserted. (1997-181, s. 1.)

OFFICIAL COMMENT

This section adapts the rules of negotiable instruments law concerning procedure in actions on instruments, see Section 3-308, to actions on certificated securities governed by this Article. An "action on a security" includes any action or proceeding brought against the issuer to enforce a right or interest that is part of the security, such as an action to collect principal or interest or a dividend, or to establish a right to vote or to receive a new security under an exchange offer or plan of reorganization. This section applies only to certificated securities; actions on uncertificated securities are governed by general evidentiary principles.

Definitional Cross References:

"Action"	Section 1-201(1).
"Burden of establishing"	Section 1-201(8).
"Certificated security"	Section 8-102(a)(4).
"Indorsement"	Section 8-102(a)(11).
"Issuer"	Section 8-201.
"Presumed"	Section 1-201(31).
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).

§ 25-8-115. Securities intermediary and others not liable to adverse claimant.

A securities intermediary that has transferred a financial asset pursuant to an effective entitlement order, or a broker or other agent or bailee that has dealt with a financial asset at the direction of its customer or principal, is not liable to a person having an adverse claim to the financial asset, unless the securities intermediary, or broker or other agent or bailee:

(1) Took the action after it had been served with an injunction, restraining order, or other legal process enjoining it from doing so, issued by a court of competent jurisdiction, and had a reasonable opportunity to act on the injunction, restraining order, or other legal process; or

(2) Acted in collusion with the wrongdoer in violating the rights of the adverse claimant; or

(3) In the case of a security certificate that has been stolen, acted with notice of the adverse claim. (1997-181, s. 1.)

OFFICIAL COMMENT

1. Other provisions of Article 8 protect certain purchasers against adverse claims, both for the direct holding system and the indirect holding system. See Sections 8-303 and 8-502. This section deals with the related question of the possible liability of a person who acted as the "conduit" for a securities transaction.

It covers both securities intermediaries — the "conduits" in the indirect holding system — and brokers or other agents or bailees — the "conduits" in the direct holding system. The following examples illustrate its operation:

> *Example 1.* John Doe is a customer of the brokerage firm of Able & Co. Doe delivers to Able a certificate for 100 shares of XYZ Co. common stock, registered in Doe's name and properly indorsed, and asks the firm to sell it for him. Able does so. Later, John Doe's spouse Mary Doe brings an action against Able asserting that Able's action was wrongful against her because the XYZ Co. stock was marital property in which she had an interest, and John Doe was acting wrongfully against her in transferring the securities.
>
> *Example 2.* Mary Roe is a customer of the brokerage firm of Baker & Co. and holds her securities through a securities account with Baker. Roe instructs Baker to sell 100 shares of XYZ Co. common stock that she carried in her account. Baker does so. Later, Mary Roe's spouse John Roe brings an action against Baker asserting that Baker's action was wrongful against him because the XYZ Co. stock was marital property in which he had an interest, and Mary Roe was acting wrongfully against him in transferring the securities.

Under common law conversion principles, Mary Doe might be able to assert that Able & Co. is liable to her in Example 1 for exercising dominion over property inconsistent with her rights in it. On that or some similar theory John Roe might assert that Baker is liable to him in Example 2. Section 8-115 protects both Able and Baker from liability.

2. The policy of this section is similar to that of many other rules of law that protect agents and bailees from liability as innocent converters. If a thief steals property and ships it by mail, express service, or carrier, to another person, the recipient of the property does not obtain good title, even though the recipient may have given value to the thief and had no notice or knowledge that the property was stolen. Accordingly, the true owner can recover the property from the recipient or obtain damages in a conversion or similar action. An action against the postal service, express company, or carrier presents entirely different policy considerations. Accordingly, general tort law protects agents or bailees who act on the instructions of their principals or bailors. See Restatement (Second) of Torts § 235. See also UCC Section 7-404.

3. Except as provided in paragraph 3, this section applies even though the securities intermediary, or the broker or other agent or bailee, had notice or knowledge that another person asserts a claim to the securities. Consider the following examples:

> *Example 3.* Same facts as in Example 1, except that before John Doe brought the XYZ Co. security certificate to Able for sale, Mary Doe telephoned or wrote to the firm asserting that she had an interest in all of John Doe's securities and demanding that they not trade for him.
>
> *Example 4.* Same facts as in Example 2, except that before Mary Roe gave an entitlement order to Baker to sell the XYZ Co. securities from her account, John Roe telephoned or wrote to the firm asserting that he had an interest in all of Mary Roe's securities and demanding that they not trade for her.

Section 8-115 protects Able and Baker from liability. The protections of Section 8-115 do not depend on the presence or absence of notice of adverse claims. It is essential to the securities settlement system that brokers and securities intermediaries be able to act promptly on the directions of their customers. Even though a firm has notice that someone asserts a claim to a customer's securities or security entitlements, the firm should not be placed in the position of having to make a legal judgment about the validity of the claim at the risk of liability either to its customer or to the third party for guessing wrong. Under this section, the broker or securities intermediary is privileged to act on the instructions of its customer or entitlement holder, unless it has been served with a restraining order or other legal process enjoining it from doing so. This is already the law in many jurisdictions. For example a section of the New York Banking Law provides that banks need not recognize any adverse claim to funds or securities on deposit with them unless they have been served with legal process. N.Y. Banking Law § 134. Other sections of the UCC embody a similar policy. See Sections 3-602 and 5-114(2)(b).

Paragraph (1) of this section refers only to a court order enjoining the securities intermediary or the broker or other agent or bailee from acting at the instructions of the customer. It does not apply to cases where the adverse claimant tells the intermediary or broker that the customer has been enjoined, or shows the intermediary or broker a copy of a court order binding the customer.

Paragraph (3) takes a different approach in one limited class of cases, those where a customer sells stolen certificated securities through a securities firm. Here the policies that lead to protection of securities firms against assertions of other sorts of claims must be weighed against the desirability of having securities firms guard against the disposition of stolen securities. Accordingly, paragraph (3) denies protection to a broker, custodian, or other agent or bailee who receives a stolen security certificate from its customer, if the broker, custodian, or other agent or bailee had notice of adverse claims. The circumstances that give notice of adverse claims are specified in Section 8-105. The result is that brokers, custodians, and other agents and bailees face the same liability for selling stolen certificated securities that purchasers face for buying them.

4. As applied to securities intermediaries, this section embodies one of the fundamental principles of the Article 8 indirect holding system rules — that a securities intermediary owes duties only to its own entitlement holders. The following examples illustrate the operation of this section in the multi-tiered indirect holding system:

Example 5. Able & Co., a broker-dealer, holds 50,000 shares of XYZ Co. stock in its account at Clearing Corporation. Able acquired the XYZ shares from another firm, Baker & Co., in a transaction that Baker contends was tainted by fraud, giving Baker a right to rescind the transaction and recover the XYZ shares from Able. Baker sends notice to Clearing Corporation stating that Baker has a claim to the 50,000 shares of XYZ Co. in Able's account. Able then initiates an entitlement order directing Clearing Corporation to transfer the 50,000 shares of XYZ Co. to another firm in settlement of a trade. Under Section 8-115, Clearing Corporation is privileged to comply with Able's entitlement order, without fear of liability to Baker. This is so even though Clearing Corporation has notice of Baker's claim, unless Baker obtains a court order enjoining Clearing Corporation from acting on Able's entitlement order.

Example 6. Able & Co., a broker-dealer, holds 50,000 shares of XYZ Co. stock in its account at Clearing Corporation. Able initiates an entitlement order directing Clearing Corporation to transfer the 50,000 shares of XYZ Co. to another firm in settlement of a trade. That trade was made by Able for its own account, and the proceeds were devoted to its own use. Able becomes insolvent, and it is discovered that Able has a shortfall in the shares of XYZ Co. stock that it should have been carrying for its customers. Able's customers bring an action against Clearing Corporation asserting that Clearing Corporation acted wrongfully in transferring the XYZ shares on Able's order because those were shares that should have been held by Able for its customers. Under Section 8-115, Clearing Corporation is not liable to Able's customers, because Clearing Corporation acted on an effective entitlement order of its own entitlement holder, Able. Clearing Corporation's protection against liability does not depend on the presence or absence of notice or knowledge of the claim by Clearing Corporation.

5. If the conduct of a securities intermediary or a broker or other agent or bailee rises to a level of complicity in the wrongdoing of its customer or principal, the policies that favor protection against liability do not apply. Accordingly, paragraph (2) provides that the protections of this section do not apply if the securities intermediary or broker or other agent or bailee acted in collusion with the customer or principal in violating of the rights of another person. The collusion test is intended to adopt a standard akin to the tort rules that determine whether a person is liable as an aider or abettor for the tortious conduct of a third party. See Restatement (Second) of Torts § 876.

Knowledge that the action of the customer is wrongful is a necessary but not sufficient condition of the collusion test. The aspect of the role of securities intermediaries and brokers that Article 8 deals with is the clerical or ministerial role of implementing and recording the securities transactions that their customers conduct. Faithful performance of this role consists of following the instructions of the customer. It is not the role of the record-keeper to police whether the transactions recorded are appropriate, so mere awareness that the customer may be acting wrongfully does not itself constitute collusion. That, of course, does not insulate an intermediary or broker from responsibility in egregious cases where its action goes beyond the ordinary standards of the business of implementing and recording transactions, and reaches a level of affirmative misconduct in assisting the customer in the commission of a wrong.

Definitional Cross References:

"Broker"	Section 8-102(a)(3).
"Effective"	Section 8-107.
"Entitlement order"	Section 8-102(a)(8).
"Financial asset"	Section 8-102(a)(9).
"Securities intermediary"	Section 8-102(a)(14).
"Security certificate"	Section 8-102(a)(16).

§ 25-8-116. Securities intermediary as purchaser for value.

A securities intermediary that receives a financial asset and establishes a security entitlement to the financial asset in favor of an entitlement holder is a purchaser for value of the financial asset. A securities intermediary that acquires a security entitlement to a financial asset from another securities intermediary acquires the security entitlement for value if the securities intermediary acquiring the security entitlement establishes a security entitlement to the financial asset in favor of an entitlement holder. (1997-181, s. 1.)

OFFICIAL COMMENT

1. This section is intended to make explicit two points that, while implicit in other provisions, are of sufficient importance to the operation of the indirect holding system that they warrant explicit statement. First, it makes clear that a securities intermediary that receives a financial asset and establishes a security entitlement in respect thereof in favor of an entitlement holder is a "purchaser" of the financial asset that the securities intermediary received. Second, it makes clear that by establishing a security entitlement in favor of an entitlement holder a securities intermediary gives value for any corresponding financial asset that the securities intermediary receives or acquires from another party, whether the intermediary holds directly or indirectly.

In many cases a securities intermediary that receives a financial asset will also be transferring value to the person from whom the financial asset was received. That, however, is not always the case. Payment may occur through a different system than settlement of the securities side of the transaction, or the securities might be transferred without a corresponding payment, as when a person moves an account from one securities intermediary to another. Even though the securities intermediary does not give value to the transferor, it does give value by incurring obligations to its own entitlement holder. Although the general definition of value in Section 1-201(44)(d) should be interpreted to cover the point, this section is included to make this point explicit.

2. The following examples illustrate the effect of this section:

Example 1. Buyer buys 1000 shares of XYZ Co. common stock through Buyer's broker Able & Co. to be held in Buyer's securities account. In settlement of the trade, the selling broker delivers to Able a security certificate in street name, indorsed in blank, for 1000 shares XYZ Co. stock, which Able holds in its vault. Able credits Buyer's account for securities in that amount. Section 8-116 specifies that Able is a purchaser of the XYZ Co. stock certificate, and gave value for it. Thus, Able can obtain the benefit of Section 8-303, which protects purchasers for value, if it satisfies the other requirements of that section.

Example 2. Buyer buys 1000 shares XYZ Co. common stock through Buyer's broker Able & Co. to be held in Buyer's securities account. The trade is settled by crediting 1000 shares XYZ Co. stock to Able's account at Clearing Corporation. Able credits Buyer's account for securities in that amount. When Clearing Corporation credits Able's account, Able acquires a security entitlement under Section 8-501. Section 8-116 specifies that Able acquired this security entitlement for value. Thus, Able can obtain the benefit of Section 8-502, which protects persons who acquire security entitlements for value, if it satisfies the other requirements of that section.

Example 3. Thief steals a certificated bearer bond from Owner. Thief sends the certificate to his broker Able & Co. to be held in his securities account, and Able credits Thief's account for the bond. Section 8-116 specifies that Able is a purchaser of the bond and gave value for it. Thus, Able can obtain the benefit of Section 8-303, which protects purchasers for value, if it satisfies the other requirements of that section.

Definitional Cross References:

"Entitlement holder"	Section 8-102(a)(7).
"Financial asset"	Section 8-102(a)(9).
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).

PART 2.

ISSUE AND ISSUER.

§ 25-8-201. Issuer.

(a) With respect to an obligation on or a defense to a security, an "issuer" includes a person that:

(1) Places or authorizes the placing of its name on a security certificate, other than as authenticating trustee, registrar, transfer agent, or the like, to evidence a share, participation, or other interest in its property or in an enterprise, or to evidence its duty to perform an obligation represented by the certificate;

(2) Creates a share, participation, or other interest in its property or in an enterprise, or undertakes an obligation, that is an uncertificated security;

(3) Directly or indirectly creates a fractional interest in its rights or property, if the fractional interest is represented by a security certificate; or

(4) Becomes responsible for, or in place of, another person described as an issuer in this section.

(b) With respect to an obligation on or defense to a security, a guarantor is an issuer to the extent of its guaranty, whether or not its obligation is noted on a security certificate.

(c) With respect to a registration of a transfer, issuer means a person on whose behalf transfer books are maintained. (1899, c. 733, ss. 29, 60 to 62; Rev., ss. 2177, 2209 to 2211; C.S., ss. 3009, 3041 to 3043; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1989 (Reg. Sess., 1990), c. 1024, s. 9(b); 1997-181, s. 1.)

OFFICIAL COMMENT

1. The definition of "issuer" in this section functions primarily to describe the persons whose defenses may be cut off under the rules in Part 2. In large measure it simply tracks the language of the definition of security in Section 8-102(a)(15).

2. Subsection (b) distinguishes the obligations of a guarantor as issuer from those of the principal obligor. However, it does not exempt the guarantor from the impact of subsection (d) of Section 8-202. Whether or not the obligation of the guarantor is noted on the security is immaterial. Typically, guarantors are parent corporations, or stand in some similar relationship to the principal obligor. If that relationship existed at the time the security was originally issued the guaranty would probably have been noted on the security. However, if the relationship arose afterward, e.g.,

through a purchase of stock or properties, or through merger or consolidation, probably the notation would not have been made. Nonetheless, the holder of the security is entitled to the benefit of the obligation of the guarantor.

3. Subsection (c) narrows the definition of "issuer" for purposes of Part 4 of this Article (registration of transfer). It is supplemented by Section 8-407.

Definitional Cross References:

"Person" Section 1-201(30).
"Security" Section 8-102(a)(15).
"Security certificate" Section 8-102(a)(16).
"Uncertificated security" Section 8-102(a)(18).

§ 25-8-202. Issuer's responsibility and defenses; notice of defect or defense.

(a) Even against a purchaser for value and without notice, the terms of a certificated security include terms stated on the certificate and terms made part of the security by reference on the certificate to another instrument, indenture, or document or to a constitution, statute, ordinance, rule, regulation, order, or the like, to the extent the terms referred to do not conflict with terms stated on the certificate. A reference under this subsection does not of itself charge a purchaser for value with notice of a defect going to the validity of the security, even if the certificate expressly states that a person accepting it admits notice. The terms of an uncertificated security include those stated in any instrument, indenture, or document or in a constitution, statute, ordinance, rule, regulation, order, or the like, pursuant to which the security is issued.

(b) The following rules apply if an issuer asserts that a security is not valid:

(1) A security other than one issued by a government or governmental subdivision, agency, or instrumentality, even though issued with a defect going to its validity, is valid in the hands of a purchaser for value and without notice of the particular defect unless the defect involves a violation of a constitutional provision. In that case, the security is valid in the hands of a purchaser for value and without notice of the defect, other than one who takes by original issue.

(2) Subdivision (1) of this subsection applies to an issuer that is a government or governmental subdivision, agency, or instrumentality only if there has been substantial compliance with the legal requirements governing the issue or the issuer has received a substantial consideration for the issue as a whole or for the particular security and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security.

(c) Except as otherwise provided in G.S. 25-8-205, lack of genuineness of a certificated security is a complete defense, even against a purchaser for value and without notice.

(d) All other defenses of the issuer of a security, including nondelivery and conditional delivery of a certificated security, are ineffective against a purchaser for value who has taken the security without notice of the particular defense.

(e) This section does not affect the right of a party to cancel a contract for a security "when, as and if issued" or "when distributed" in the event of a material change in the character of the security that is the subject of the contract or in the plan or arrangement pursuant to which the security is to be issued or distributed.

(f) If a security is held by a securities intermediary against whom an entitlement holder has a security entitlement with respect to the security, the issuer may not assert any defense that the issuer could not assert if the entitlement holder held the security directly. (1899, c. 733, ss. 23, 28, 56, 57, 61, 62; Rev., ss. 2171, 2176, 2205, 2206, 2210, 2211; C.S., ss. 3003, 3008, 3037, 3038, 3042, 3043; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. In this Article the rights of the purchaser for value without notice are divided into two aspects, those against the issuer, and those against other claimants to the security. Part 2 of this Article, and especially this section, deal with rights against the issuer.

Subsection (a) states, in accordance with the prevailing case law, the right of the issuer (who prepares the text of the security) to include terms incorporated by adequate reference to an extrinsic source, so long as the terms so incorporated do not conflict with the stated terms. Thus, the standard practice of referring in a bond or debenture to the trust indenture under which it is issued without spelling out its necessarily complex and lengthy provisions is approved. Every stock certificate refers in some manner to the charter or articles of incorporation of the issuer. At least where there is more than one class of stock authorized applicable corporation codes specifically require a statement or summary as to preferences, voting powers, and the like. References to constitutions, statutes, ordinances, rules, regulations or orders are not so common, except in the obligations of governments or governmental agencies or units; but where appropriate they fit into the rule here stated.

Courts have generally held that an issuer is estopped from denying representations made in the text of a security. *Delaware-New Jersey Ferry Co. v. Leeds,* 21 Del.Ch. 279, 186 A. 913 (1936). Nor is a defect in form or the invalidity of a security normally available to the issuer as a defense. *Bonini v. Family Theatre Corporation,* 327 Pa. 273, 194 A. 498 (1937); *First National Bank of Fairbanks v. Alaska Airmotive,* 119 F.2d 267 (C.C.A.Alaska 1941).

2. The rule in subsection (a) requiring that the terms of a security be noted or referred to on the certificate is based on practices and expectations in the direct holding system for certificated securities. This rule does not express a general rule or policy that the terms of a security are effective only if they are communicated to beneficial owners in some particular fashion. Rather, subsection (a) is based on the principle that a purchaser who does obtain a certificate is entitled to assume that the terms of the security have been noted or referred to on the certificate. That policy does not come into play in a securities holding system in which purchasers do not take delivery of certificates.

The provisions of subsection (a) concerning notation of terms on security certificates are necessary only because paper certificates play such an important role for certificated securities that a purchaser should be protected against assertion of any defenses or rights that are not noted on the certificate. No similar problem exists with respect to uncertificated securities. The last sentence of subsection (a) is, strictly speaking, unnecessary, since it only recognizes the fact that the terms of an uncertificated security are determined by whatever other law or agreement governs the security. It is included only to preclude any inference that uncertificated securities are subject to any requirement analogous to the requirement of notation of terms on security certificates.

The rule of subsection (a) applies to the indirect holding system only in the sense that if a certificated security has been delivered to the clearing corporation or other securities intermediary, the terms of the security should be noted or referred to on the certificate. If the security is uncertificated, that principle does not apply even at the issuer-clearing corporation level. The beneficial owners who hold securities through the clearing corporation are bound by the terms of the security, even though they do not actually see the certificate. Since entitlement holders in an indirect holding system have not taken delivery of certificates, the policy of subsection (a) does not apply.

3. The penultimate sentence of subsection (a) and all of subsection (b) embody the concept that it is the duty of the issuer, not of the purchaser, to make sure that the security complies with the law governing its issue. The penultimate sentence of subsection (a) makes clear

that the issuer cannot, by incorporating a reference to a statute or other document, charge the purchaser with notice of the security's invalidity. Subsection (b) gives to a purchaser for value without notice of the defect the right to enforce the security against the issuer despite the presence of a defect that otherwise would render the security invalid. There are three circumstances in which a purchaser does not gain such rights: First, if the defect involves a violation of constitutional provisions, these rights accrue only to a subsequent purchaser, that is, one who takes other than by original issue. This Article leaves to the law of each particular State the rights of a purchaser on original issue of a security with a constitutional defect. No negative implication is intended by the explicit grant of rights to a subsequent purchaser.

Second, governmental issuers are distinguished in subsection (b) from other issuers as a matter of public policy, and additional safeguards are imposed before governmental issues are validated. Governmental issuers are estopped from asserting defenses only if there has been substantial compliance with the legal requirements governing the issue or if substantial consideration has been received and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security. The purpose of the substantial compliance requirement is to make certain that a mere technicality as, e.g., in the manner of publishing election notices, shall not be a ground for depriving an innocent purchaser of rights in the security. The policy is here adopted of such cases as *Tommie v. City of Gadsden,* 229 Ala. 521, 158 So. 763 (1935), in which minor discrepancies in the form of the election ballot used were overlooked and the bonds were declared valid since there had been substantial compliance with the statute.

A long and well established line of federal cases recognizes the principle of estoppel in favor of purchasers for value without notices where municipalities issue bonds containing recitals of compliance with governing constitutional and statutory provisions, made by the municipal authorities entrusted with determining such compliance. *Chaffee County v. Potter,* 142 U.S. 355 (1892); *Town of Oregon v. Jennings,* 119 U.S. 74 (1886); *Gunnison County Commissioners v. Rollins,* 173 U.S. 255 (1898). This rule has been qualified, however, by requiring that the municipality have power to issue the security. *Anthony v. County of Jasper,* 101 U.S. 693 (1879); *Town of South Ottawa v. Perkins,* 94 U.S. 260 (1876). This section follows the case law trend, simplifying the rule by setting up two conditions for an estoppel against a governmental issuer: (1) Substantial consideration given, and (2) power in the issuer to borrow money or issue the security for the stated purpose. As a practical matter the problem of policing governmental issuers has been alleviated by the present practice of requiring legal opinions as to the validity of the issue. The bulk of the case law on this point is nearly 100 years old and it may be assumed that the question now seldom arises.

Section 8-210, regarding overissue, provides the third exception to the rule that an innocent purchase for value takes a valid security despite the presence of a defect that would otherwise give rise to invalidity. See that section and its Comment for further explanation.

4. Subsection (e) is included to make clear that this section does not affect the presently recognized right of either party to a "when, as, and if" or "when distributed" contract to cancel the contract on substantial change.

5. Subsection (f) has been added because the introduction of the security entitlement concept requires some adaptation of the Part 2 rules, particularly those that distinguish between purchasers who take by original issue and subsequent purchasers. The basic concept of Part 2 is to apply to investment securities the principle of negotiable instruments law that an obligor is precluded from asserting most defenses against purchasers for value without notice. Section 8-202 describes in some detail which defenses issuers can raise against purchasers for value and subsequent purchasers for value. Because these rules were drafted with the direct holding system in mind, some interpretive problems might be presented in applying them to the indirect holding. For example, if a municipality issues a bond in book-entry only form, the only direct "purchaser" of that bond would be the clearing corporation. The policy of precluding the issuer from asserting defenses is, however, equally applicable. Subsection (f) is designed to ensure that the defense preclusion rules developed for the direct holding system will also apply to the indirect holding system.

Definitional Cross References:

"Certificated security" Section 8-102(a)(4).

"Notice" Section 1-201(25).

"Purchaser" Sections 1-201(33) & 8-116.

"Security" Section 8-102(a)(15).

"Uncertificated security" Section 8-102(a)(18).

"Value" Sections 1-201(44) & 8-116.

§ 25-8-203. Staleness as notice of defect or defense.

After an act or event, other than a call that has been revoked, creating a right to immediate performance of the principal obligation represented by a certificated security or setting a date on or after which the security is to be presented or surrendered for redemption or exchange, a purchaser is charged with notice of any defect in its issue or defense of the issuer, if the act or event:

(1) Requires the payment of money, the delivery of a certificated security, the registration of transfer of an uncertificated security, or any of them on presentation or surrender of the security certificate, the money or security is available on the date set for payment or exchange, and the purchaser takes the security more than one year after that date; or

(2) Is not covered by subdivision (1) of this section and the purchaser takes the security more than two years after the date set for surrender or presentation or the date on which performance became due. (1899, c. 733, ss. 52, 53; Rev., ss. 2201, 2202; C.S., ss. 3033, 3034; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. The problem of matured or called securities is here dealt with in terms of the effect of such events in giving notice of the issuer's defenses and not in terms of "negotiability". The substance of this section applies only to certificated securities because certificates may be transferred to a purchaser by delivery after the security has matured, been called, or become redeemable or exchangeable. It is contemplated that uncertificated securities which have matured or been called will merely be canceled on the books of the issuer and the proceeds sent to the registered owner. Uncertificated securities which have become redeemable or exchangeable, at the option of the owner, may be transferred to a purchaser, but the transfer is effectuated only by registration of transfer, thus necessitating communication with the issuer. If defects or defenses in such securities exist, the issuer will necessarily have the opportunity to bring them to the attention of the purchaser.

2. The fact that a security certificate is in circulation long after it has been called for redemption or exchange must give rise to the question in a purchaser's mind as to why it has not been surrendered. After the lapse of a reasonable period of time a purchaser can no longer claim "no reason to know" of any defects or irregularities in its issue. Where funds are available for the redemption the security certificate is normally turned in more promptly and a shorter time is set as the "reasonable period" than is set where funds are not available.

Defaulted certificated securities may be traded on financial markets in the same manner as unmatured and undefaulted instruments and a purchaser might not be placed upon notice of irregularity by the mere fact of default. An issuer, however, should at some point be placed in a position to determine definitely its liability on an invalid or improper issue, and for this purpose a security under this section becomes "stale" two years after the default. A different rule applies when the question is notice not of issuer's defenses but of claims of ownership. Section 8-105 and comment.

3. Nothing in this section is designed to extend the life of preferred stocks called for redemption as "shares of stock"

beyond the redemption date. After such a call, the security represents only a right to the funds set aside for redemption.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Notice"	Section 1-201(25).
"Purchaser"	Sections 1-201(33) & 8-116.
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-204. Effect of issuer's restriction on transfer.

A restriction on transfer of a security imposed by the issuer, even if otherwise lawful, is ineffective against a person without knowledge of the restriction unless:

(1) The security is certificated and the restriction is noted conspicuously on the security certificate; or

(2) The security is uncertificated and the registered owner has been notified of the restriction. (1941, c. 353, s. 15; G.S., s. 55-95; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Restrictions on transfer of securities are imposed by issuers in a variety of circumstances and for a variety of purposes, such as to retain control of a close corporation or to ensure compliance with federal securities laws. Other law determines whether such restrictions are permissible. This section deals only with the consequences of failure to note the restriction on a security certificate.

This section imposes no bar to enforcement of a restriction on transfer against a person who has actual knowledge of it.

2. A restriction on transfer of a certificated security is ineffective against a person without knowledge of the restriction unless the restriction is noted conspicuously on the certificate. The word "noted" is used to make clear that the restriction need not be set forth in full text. Refusal by an issuer to register a transfer on the basis of an unnoted restriction would be a violation of the issuer's duty to register under Section 8-401.

3. The policy of this section is the same as in Section 8-202. A purchaser who takes delivery of a certificated security is entitled to rely on the terms stated on the certificate. That policy obviously does not apply to uncertificated securities. For uncertificated securities, this section requires only that the registered owner has been notified of the restriction. Suppose, for example, that A is the registered owner of an uncertificated security, and that the issuer has notified A of a restriction on transfer. A agrees to sell the security to B, in violation of the restriction. A completes a written instruction directing the issuer to register transfer to B, and B pays A for the security at the time A delivers the instruction to B. A does not inform B of the restriction, and B does not otherwise have notice or knowledge of it at the time B pays and receives the instruction. B presents the instruction to the issuer, but the issuer refuses to register the transfer on the grounds that it would violate the restriction. The issuer has complied with this section, because it did notify the registered owner A of the restriction. The issuer's refusal to register transfer is not wrongful. B has an action against A for breach of transfer warranty, see Section 8-108(b)(4)(iii). B's mistake was treating an uncertificated security transaction in the fashion appropriate only for a certificated security. The mechanism for transfer of uncertificated securities is registration of transfer on the books of the issuer; handing over an instruction only initiates the process. The purchaser should make arrangements to ensure that the price is not paid until it knows that the issuer has or will register transfer.

4. In the indirect holding system, investors neither take physical delivery of security certificates nor have uncertificated securities registered in their names. So long as the requirements of this section have been satisfied at the level of the relationship between the is-

suer and the securities intermediary that is a direct holder, this section does not preclude the issuer from enforcing a restriction on transfer. See Section 8-202(a) and comment 2 thereto.

5. This section deals only with restrictions imposed by the issuer. Restrictions imposed by statute are not affected. See *Quiner v. Marblehead Social Co.,* 10 Mass. 476 (1813); *Madison Bank v. Price,* 79 Kan. 289, 100 P. 280 (1909); *Healey v. Steele Center Creamery Ass'n,* 115 Minn. 451, 133 N.W. 69 (1911). Nor does it deal with private agreements between stockholders containing restrictive covenants as to the sale of the security.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Conspicuous"	Section 1-201(10).
"Issuer"	Section 8-201.
"Knowledge"	Section 1-201(25).
"Notify"	Section 1-201(26).
"Purchaser"	Sections 1-201(33) & 8-116.
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-205. Effect of unauthorized signature on security certificate.

An unauthorized signature placed on a security certificate before or in the course of issue is ineffective, but the signature is effective in favor of a purchaser for value of the certificated security if the purchaser is without notice of the lack of authority and the signing has been done by:

(1) An authenticating trustee, registrar, transfer agent, or other person entrusted by the issuer with the signing of the security certificate or of similar security certificates, or the immediate preparation for signing of any of them; or

(2) An employee of the issuer, or of any of the persons listed in subdivision (1) of this section, entrusted with responsible handling of the security certificate. (1899, c. 733, s. 23; Rev., s. 2171; C.S., s. 3003; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. The problem of forged or unauthorized signatures may arise where an employee of the issuer, transfer agent, or registrar has access to securities which the employee is required to prepare for issue by affixing the corporate seal or by adding a signature necessary for issue. This section is based upon the issuer's duty to avoid the negligent entrusting of securities to such persons. Issuers have long been held responsible for signatures placed upon securities by parties whom they have held out to the public as authorized to prepare such securities. *See Fifth Avenue Bank of New York v. The Forty-Second & Grand Street Ferry Railroad Co.,* 137 N.Y. 231, 33 N.E. 378, 19 L.R.A. 331, 33 Am.St.Rep. 712 (1893); *Jarvis v. Manhattan Beach Co.,* 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). The "apparent authority" concept of some of the caselaw, however, is here extended and this section expressly rejects the technical distinction, made by courts reluctant to recognize forged signatures, between cases where forgers sign signatures they are authorized to sign under proper circumstances and those in which they sign signatures they are never authorized to sign. *Citizens' & Southern National Bank v. Trust Co. of Georgia,* 50 Ga.App. 681, 179 S.E. 278 (1935). Normally the purchaser is not in a position to determine which signature a forger, entrusted with the preparation of securities, has "apparent authority" to sign. The issuer, on the other hand, can protect itself against such fraud by the careful selection and bonding of agents and employees, or by action over against transfer agents and registrars who in turn may bond their personnel.

2. The issuer cannot be held liable for the honesty of employees not entrusted, directly or indirectly, with the signing, preparation, or responsible handling of similar securities and whose possible

commission of forgery it has no reason to anticipate. The result in such cases as *Hudson Trust Co. v. American Linseed Co.,* 232 N.Y. 350, 134 N.E. 178 (1922), *and Dollar Savings Fund & Trust Co. v. Pittsburgh Plate Glass Co.,* 213 Pa. 307, 62 A. 916, 5 Ann.Cas. 248 (1906) is here adopted.

3. This section is not concerned with forged or unauthorized indorsements, but only with unauthorized signatures of issuers, transfer agents, etc., placed upon security certificates during the course of their issue. The protection here stated is available to all purchasers for value without notice and not merely to subsequent purchasers.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Issuer"	Section 8-201.
"Notice"	Section 1-201(25).
"Purchaser"	Sections 1-201(33) & 8-116.
"Security certificate"	Section 8-102(a)(14).
"Unauthorized' signature"	Section 1-201(43).

§ 25-8-206. Completion of alteration of security certificate.

(a) If a security certificate contains the signatures necessary to its issue or transfer but is incomplete in any other respect:

(1) Any person may complete it by filling in the blanks as authorized; and

(2) Even if the blanks are incorrectly filled in, the security certificate as completed is enforceable by a purchaser who took it for value and without notice of the incorrectness.

(b) A complete security certificate that has been improperly altered, even if fraudulently, remains enforceable, but only according to its original terms. (1899, c. 733, ss. 14, 15, 124; Rev., ss. 2164, 2165, 2274; C.S., ss. 2995, 2996, 3106; 1941, c. 353, s. 16; G.S., s. 55-96; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. The problem of forged or unauthorized signatures necessary for the issue or transfer of a security is not involved here, and a person in possession of a blank certificate is not, by this section, given authority to fill in blanks with such signatures. Completion of blanks left in a transfer instruction is dealt with elsewhere (Section 8-305(a)).

2. Blanks left upon issue of a security certificate are the only ones dealt with here, and a purchaser for value without notice is protected. A purchaser is not in a good position to determine whether blanks were completed by the issuer or by some person not authorized to complete them. On the other hand the issuer can protect itself by not placing its signature on the writing until the blanks are completed or, if it does sign before all blanks are completed, by carefully selecting the agents and employees to whom it entrusts the writing after authentication. With respect to a security certificate that is completed by the issuer but later is altered, the issuer has done everything it can to protect the purchaser and thus is not charged with the terms as altered. However, it is charged according to the original terms, since it is not thereby prejudiced. If the completion or alteration is obviously irregular, the purchaser may not qualify as a purchaser who took without notice under this section.

3. Only the purchaser who physically takes the certificate is directly protected. However, a transferee may receive protection indirectly through Section 8-302(a).

4. The protection granted a purchaser for value without notice under this section is modified to the extent that an overissue may result where an incorrect amount is inserted into a blank (Section 8-210).

Definitional Cross References:

"Notice"	Section 1-201(25).
"Purchaser"	Sections 1-201(33) & 8-116.
"Security certificate"	Section 8-102(a)(16).

"Unauthorized signature" Section 1-201(43).
"Value" Sections 1-201(44) & 8-116.

§ 25-8-207. Rights and duties of issuer with respect to registered owners.

(a) Before due presentment for registration of transfer of a certificated security in registered form or of an instruction requesting registration of transfer of an uncertificated security, the issuer or indenture trustee may treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner.

(b) This Article does not affect the liability of the registered owner of a security for a call, assessment, or the like. (1941, c. 353, s. 3; G.S., s. 55-83; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) states the issuer's right to treat the registered owner of a security as the person entitled to exercise all the rights of an owner. This right of the issuer is limited by the provisions of Part 4 of this article. Once there has been due presentation for registration of transfer, the issuer has a duty to register ownership in the name of the transferee. Section 8-401. Thus its right to treat the old registered owner as exclusively entitled to the rights of ownership must cease.

The issuer may under this section make distributions of money or securities to the registered owners of securities without requiring further proof of ownership, provided that such distributions are distributable to the owners of all securities of the same issue and the terms of the security do not require surrender of a security certificate as a condition of payment or exchange. Any such distribution shall constitute a defense against a claim for the same distribution by a person, even if that person is in possession of the security certificate and is a protected purchaser of the security. See PEB Commentary No. 4, dated March 10, 1990.

2. Subsections (a) is permissive and does not require that the issuer deal exclusively with the registered owner. It is free to require proof of ownership before paying out dividends or the like if it chooses to. *Barbato v. Breeze Corporations, 128 N.J.L. 309, 26 A.2d 53 (1942).*

3. This section does not operate to determine who is finally entitled to exercise voting and other rights or to receive payments and distributions. The parties are still free to incorporate their own arrangements as to these matters in seller-purchaser agreements which may be definitive as between them.

4. No change in existing state laws as to the liability of registered owners for calls and assessments is here intended; nor is anything in this section designed to estop record holders from denying ownership when assessments are levied if they are otherwise entitled to do so under state law. See *State ex rel. Squire v. Murfey, Blosson & Co.,* 131 Ohio St. 289, 2 N.E.2d 866 (1936); *Willing v. Delaplaine,* 23 F.Supp. 579 (1937).

5. No interference is intended with the common practice of closing the transfer books or taking a record date for dividend, voting, and other purposes, as provided for in by-laws, charters, and statutes.

Definitional Cross References:
"Certificated security" Section 8-102(a)(4).
"Instruction" Section 8-102(a)(12).
"Issuer" Section 8-201.
"Registered form" Section 8-102(a)(13).
"Security" Section 8-102(a)(15).
"Uncertificated security" Section 8-102(a)(18).

§ 25-8-208. Effect of signature of authenticating trustee, registrar, or transfer agent.

(a) A person signing a security certificate as authenticating trustee, registrar, transfer agent, or the like, warrants to a purchaser for value of the certificated security, if the purchaser is without notice of a particular defect, that:

(1) The certificate is genuine;

(2) The person's own participation in the issue of the security is within the person's capacity and within the scope of the authority received by the person from the issuer; and

(3) The person has reasonable grounds to believe that the certificated security is in the form and within the amount the issuer is authorized to issue.

(b) Unless otherwise agreed, a person signing under subsection (a) of this section does not assume responsibility for the validity of the security in other respects. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. The warranties here stated express the current understanding and prevailing case law as to the effect of the signatures of authenticating trustees, transfer agents, and registrars. See *Jarvis v. Manhattan Beach Co.,* 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). Although it has generally been regarded as the particular obligation of the transfer agent to determine whether securities are in proper form as provided by the by-laws and Articles of Incorporation, neither a registrar nor an authenticating trustee should properly place a signature upon a certificate without determining whether it is at least regular on its face. The obligations of these parties in this respect have therefor been made explicit in terms of due care. See *Feldmeier v. Mortgage Securities, Inc.,* 34 Cal.App.2d 201, 93 P.2d 593 (1939).

2. Those cases which hold that an authenticating trustee is not liable for any defect in the mortgage or property which secures the bond or for any fraudulent misrepresentations made by the issuer are not here affected since these matters do not involve the genuineness or proper form of the security. *Ainsa v. Mercantile Trust Co.,* 174 Cal. 504, 163 P. 898 (1917); *Tschetinian v. City Trust Co.,* 186 N.Y. 432, 79 N.E. 401 (1906); *Davidge v. Guardian Trust Co. of New York,* 203 N.Y. 331, 96 N.E. 751 (1911).

3. The charter or an applicable statute may affect the capacity of a bank or other corporation undertaking to act as an authenticating trustee, registrar, or transfer agent. See, for example, the Federal Reserve Act, (U.S.C.A. Title 12, Banks and Banking, Section 248) under which the Board of Governors of the Federal Reserve Bank is authorized to grant special permits to National Banks permitting them to act as trustees. Such corporations are therefor held to certify as to their legal capacity to act as well as to their authority.

4. Authenticating trustees, registrars, and transfer agents have normally been held liable for an issue in excess of the authorized amount. *Jarvis v. Manhattan Beach Co.,* supra; *Mullen v. Eastern Trust & Banking Co.,* 108 Me. 498, 81 A. 948 (1911). In imposing upon these parties a duty of due care with respect to the amount they are authorized to help issue, this section does not necessarily validate the security, but merely holds persons responsible for the excess issue liable in damages for any loss suffered by the purchaser.

5. Aside from questions of genuineness and excess issue, these parties are not held to certify as to the validity of the security unless they specifically undertake to do so. The case law which has recognized a unique responsibility on the transfer agent's part to testify as to the validity of any security which it countersigns is rejected.

6. This provision does not prevent a transfer agent or issuer from agreeing with a registrar of stock to protect the registrar in respect of the genuineness and proper form of a security certificate signed by the issuer or the transfer agent or both. Nor does it interfere with proper indemnity arrangements between the is-

suer and trustees, transfer agents, registrars, and the like.

7. An unauthorized signature is a signature for purposes of this section if and only if it is made effective by Section 8-205.

Definitional Cross References:

"Certificated security" Section 8-102(a)(4).
"Genuine" Section 1-201(18).
"Issuer" Section 8-201.
"Notice" Section 1-201(25).
"Purchaser" Sections 1-201(33) & 8-116.
"Security" Section 8-102(a)(15).
"Security certificate" Section 8-102(a)(16).
"Uncertificated security" Section 8-102(a)(18).
"Value" Sections 1-201(44) & 8-116.

§ 25-8-209. Issuer's lien.

A lien in favor of an issuer upon a certificated security is valid against a purchaser only if the right of the issuer to the lien is noted conspicuously on the security certificate. (1997-181, s. 1.)

OFFICIAL COMMENT

This section is similar to Sections 8-202 and 8-204 which require that the terms of a certificated security and any restriction on transfer imposed by the issuer be noted on the security certificate. This section differs from those two sections in that the purchaser's knowledge of the issuer's claim is irrelevant. "Noted" makes clear that the text of the lien provisions need not be set forth in full. However, this would not override a provision of an applicable corporation code requiring statement in haec verba. This section does not apply to uncertificated securities. It applies to the indirect holding system in the same fashion as Sections 8-202 and 8-204, see Comment 2 to Section 8-202.

Definitional Cross References:

"Certificated security" Section 8-102(a)(4).
"Issuer" Section 8-201.
"Purchaser" Sections 1-201(33) & 8-116.
"Security" Section 8-102(a)(15).
"Security certificate" Section 8-102(a)(16).

§ 25-8-210. Overissue.

(a) In this section, "overissue" means the issue of securities in excess of the amount the issuer has corporate power to issue, but an overissue does not occur if appropriate action has cured the overissue.

(b) Except as otherwise provided in subsections (c) and (d) of this section, the provisions of this Article which validate a security or compel its issue or reissue do not apply to the extent that validation, issue, or reissue would result in overissue.

(c) If an identical security not constituting an overissue is reasonably available for purchase, a person entitled to issue or validation may compel the issuer to purchase the security and deliver it if certificated or register its transfer if uncertificated, against surrender of any security certificate the person holds.

(d) If a security is not reasonably available for purchase, a person entitled to issue or validation may recover from the issuer the price the person or the last purchaser for value paid for it with interest from the date of the person's demand. (1997-181, s. 1.)

OFFICIAL COMMENT

1. Deeply embedded in corporation law is the conception that "corporate power" to issue securities stems from the statute, either general or special, under which the corporation is organized. Corporation codes universally require that

the charter or articles of incorporation state, at least as to capital shares, maximum limits in terms of number of shares or total dollar capital. Historically, special incorporation statutes are similarly drawn and sometimes similarly limit the face amount of authorized debt securities. The theory is that issue of securities in excess of the authorized amounts is prohibited. See, for example, *McWilliams v. Geddes & Moss Undertaking Co.,* 169 So. 894 (1936, La.); *Crawford v. Twin City Oil Co.,* 216 Ala. 216, 113 So. 61 (1927); *New York and New Haven R.R. Co. v. Schuyler,* 34 N.Y. 30 (1865). This conception persists despite modern corporation codes under which, by action of directors and stockholders, additional shares can be authorized by charter amendment and thereafter issued. This section does not give a person entitled to validation, issue, or reissue of a security, the right to compel amendment of the charter to authorize additional shares. Therefor, in a case where issue of an additional security would require charter amendment, the plaintiff is limited to the two alternate remedies set forth in subsections (c) and (d). The last clause of subsection (a), which is added in Revised Article 8, does, however, recognize that under modern conditions, overissue may be a relatively minor technical problem that can be cured by appropriate action under governing corporate law.

2. Where an identical security is reasonably available for purchase, whether because traded on an organized market, or because one or more security owners may be willing to sell at a not unreasonable price, the issuer, although unable to issue additional shares, will be able to purchase them and may be compelled to follow that procedure. *West v. Tintic Standard Mining Co.,* 71 Utah 158, 263 P. 490 (1928).

3. The right to recover damages from an issuer who has permitted an overissue to occur is well settled. *New York and New Haven R.R. Co. v. Schuyler,* 34 N.Y. 30 (1865). The measure of such damages, however, has been open to question, some courts basing them upon the value of stock at the time registration is refused; some upon the value at the time of trial; and some upon the highest value between the time of refusal and the time of trial. *Allen v. South Boston Railroad, 150 Mass.* 200, 22 N.E. 917, 5 L.R.A. 716, 15 Am.St.Rep. 185 (1889); *Commercial Bank v. Kortright,* 22 Wend. (N.Y.) 348 (1839). The purchase price of the security to the last purchaser who gave value for it is here adopted as being the fairest means of reducing the possibility of speculation by the purchaser. Interest may be recovered as the best available measure of compensation for delay.

Definitional Cross References:

"Issuer"	Section 8-201.
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).
"Uncertificated security"	Section 8-102(a)(18).

PART 3.

TRANSFER OF CERTIFICATED AND UNCERTIFICATED SECURITIES.

§ 25-8-301. Delivery.

(a) Delivery of a certificated security to a purchaser occurs when:

(1) The purchaser acquires possession of the security certificate;

(2) Another person, other than a securities intermediary, either acquires possession of the security certificate on behalf of the purchaser or, having previously acquired possession of the certificate, acknowledges that it holds for the purchaser; or

(3) A securities intermediary acting on behalf of the purchaser acquires possession of the security certificate, only if the certificate is in registered form and has been specially indorsed to the purchaser by an effective indorsement.

(b) Delivery of an uncertificated security to a purchaser occurs when:

(1) The issuer registers the purchaser as the registered owner, upon original issue or registration of transfer; or

(2) Another person, other than a securities intermediary, either becomes the registered owner of the uncertificated security on behalf of the purchaser or, having previously become the registered owner, acknowledges that it holds for the purchaser. (1899, c. 733, ss. 52, 57 to 59; Rev., ss. 2201, 2206 to 2208; C.S., ss. 3033, 3038 to 3040; 1941, c. 353, ss. 6, 7; G.S., ss. 55-86, 55-87; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. This section specifies the requirements for "delivery" of securities. Delivery is used in Article 8 to describe the formal steps necessary for a purchaser to acquire a direct interest in a security under this Article. The concept of delivery refers to the implementation of a transaction, not the legal categorization of the transaction which is consummated by delivery. Issuance and transfer are different kinds of transactions, though both may be implemented by delivery. Sale and pledge are different kinds of transfers, but both may be implemented by delivery.

2. Subsection (a) defines delivery with respect to certificated securities. Paragraph (1) deals with simple cases where purchasers themselves acquire physical possession of certificates. Paragraphs (2) and (3) of subsection (a) specify the circumstances in which delivery to a purchaser can occur although the certificate is in the possession of a person other than the purchaser. Paragraph (2) contains the general rule that a purchaser can take delivery through another person, so long as the other person is actually acting on behalf of the purchaser or acknowledges that it is holding on behalf of the purchaser. Paragraph (2) does not apply to acquisition of possession by a securities intermediary, because a person who holds securities through a securities account acquires a security entitlement, rather than having a direct interest. See Section 8-501. Subsection (a)(3) specifies the limited circumstances in which delivery of security certificates to a securities intermediary is treated as a delivery to the customer.

3. Subsection (b) defines delivery with respect to uncertificated securities. Use of the term "delivery" with respect to uncertificated securities, does, at least on first hearing, seem a bit solecistic. The word "delivery" is, however, routinely used in the securities business in a broader sense than manual tradition. For example, settlement by entries on the books of a clearing corporation is commonly called "delivery," as in the expression "delivery versus payment." The diction of this section has the advantage of using the same term for uncertificated securities as for certificated securities, for which delivery is conventional usage. Paragraph (1) of subsection (b) provides that delivery occurs when the purchaser becomes the registered owner of an uncertificated security, either upon original issue or registration of transfer. Paragraph (2) provides for delivery of an uncertificated security through a third person, in a fashion analogous to subsection (a)(2).

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Effective"	Section 8-107.
"Issuer"	Section 8-201.
"Purchaser"	Sections 1-201(33) & 8-116.
"Registered form"	Section 8-102(a)(13).
"Securities intermediary"	Section 8-102(a)(14).
"Security certificate"	Section 8-102(a)(16).
"Special indorsement"	Section 8-304(a).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-302. Rights of purchaser.

(a) Except as otherwise provided in subsections (b) and (c) of this section, upon delivery of a certificated or uncertificated security to a purchaser, the purchaser acquires all rights in the security that the transferor had or had power to transfer.

(b) A purchaser of a limited interest acquires rights only to the extent of the interest purchased.

(c) A purchaser of a certificated security who as a previous holder had notice of an adverse claim does not improve its position by taking from a protected purchaser. (1899, c. 733, s. 52; Rev., s. 2201; C.S., s. 3033; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) provides that if a certificated or uncertificated security is delivered (Section 8-301) to a purchaser in a transfer, the purchaser acquires all rights that the transferor had or had power to transfer. This statement of the familiar "shelter" principle is qualified by the exceptions that a purchaser of a limited interest acquires only that interest, subsection (b), and that a person who does not qualify as a protected purchaser cannot improve its position by taking from a subsequent protected purchaser, subsection (c).

2. Although this section provides that a purchaser acquires a property interest in a certificated or uncertificated security upon "delivery," it does not state that a person can acquire an interest in a security only by delivery. Article 8 is not a comprehensive codification of all of the law governing the creation or transfer of interests in securities. For example, the grant of a security interest is a transfer of a property interest, but the formal steps necessary to effectuate such a transfer are governed by Article 9 not by Article 8. Under the Article 9 rules, a security interest in a certificated or uncertificated security can be created by execution of a security agreement under Section 9-203 and can be perfected by filing. A transfer of an Article 9 security interest can be implemented by an Article 8 delivery, but need not be.

Similarly, Article 8 does not determine whether a property interest in certificated or uncertificated security is acquired under other law, such as the law of gifts, trusts, or equitable remedies. Nor does Article 8 deal with transfers by operation of law. For example, transfers from decedent to administrator, from ward to guardian, and from bankrupt to trustee in bankruptcy are governed by other law as to both the time they occur and the substance of the transfer. The Article 8 rules do, however, determine whether the issuer is obligated to recognize the rights that a third party, such as a transferee, may acquire under other law. See Sections 8-207, 8-401, and 8-404.

Definitional Cross References:

"Certificated security" Section 8-102(a)(4).

"Delivery" Section 8-301.

"Notice of adverse claim" Section 8-105.

"Protected purchaser" Section 8-303.

"Purchaser" Sections 1-201(33) & 8-116.

"Uncertificated security" Section 8-102(a)(18).

Legal Periodicals. — For comment on the duty to register the transfer of investment securities, see 44 N.C.L. Rev. 854 (1966).

§ 25-8-303. Protected purchaser.

(a) "Protected purchaser" means a purchaser of a certificated or uncertificated security, or of an interest therein, who:

(1) Gives value;

(2) Does not have notice of any adverse claim to the security; and

(3) Obtains control of the certificated or uncertificated security.

(b) In addition to acquiring the rights of a purchaser, a protected purchaser also acquires its interest in the security free of any adverse claim. (1965, c. 700, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) lists the requirements that a purchaser must meet to qualify as a "protected purchaser." Subsection (b) provides that a protected purchaser takes its interest free from adverse claims. "Purchaser" is defined broadly in section 1-201. A secured party as well as an outright buyer can qualify as a protected purchaser. Also, "purchase" includes taking by issue, so a person to whom a security is originally issued can qualify as a protected purchaser.

2. To qualify as a protected purchaser, a purchaser must give value, take without notice of any adverse claim, and obtain control. Value is used in the broad sense defined in Section 1-201(44). See also Section 8-116 (securities intermediary as purchaser for value). Adverse claim is defined in Section 8-102(a)(1). Section 8-105 specifies whether a purchaser has notice of an adverse claim. Control is defined in Section 8-106. To qualify as a protected purchaser there must be a time at which all of the requirements are satisfied. Thus if a purchaser obtains notice of an adverse claim before giving value or satisfying the requirements for control, the purchaser cannot be a protected purchaser. See also Section 8-304(d).

The requirement that a protected purchaser obtain control expresses the point that to qualify for the adverse claim cut-off rule a purchaser must take through a transaction that is implemented by the appropriate mechanism. By contrast, the rules in Part 2 provide that any purchaser for value of a security without notice of a defense may take free of the issuer's defense based on that defense. See Section 8-202.

3. The requirements for control differ depending on the form of the security. For securities represented by bearer certificates, a purchaser obtains control by delivery. See Sections 8-106(a) and 8-301(a). For securities represented by certificates in registered form, the requirements for control are: (1) delivery as defined in Section 8-301(b), plus (2) either an effective indorsement or registration of transfer by the issuer. See Section 8-106(b). Thus, a person who takes through a forged indorsement does not qualify as a protected purchaser by virtue of the delivery alone. If, however, the purchaser presents the certificate to the issuer for registration of transfer, and the issuer registers transfer over the forged indorsement, the purchaser can qualify as a protected purchaser of the new certificate. If the issuer registers transfer on a forged indorsement, the true owner will be able to recover from the issuer for wrongful registration, see Section 8-404, unless the owner's delay in notifying the issuer of a loss or theft of the certificate results in preclusion under Section 8-406.

For uncertificated securities, a purchaser can obtain control either by delivery, see Sections 8-106(c)(1) and 8-301(b), or by obtaining an agreement pursuant to which the issuer agrees to act on instructions from the purchaser without further consent from the registered owner, see Section 8-106(c)(2). The control agreement device of Section 8-106(c)(2) takes the place of the "registered pledge" concept of the 1978 version of Article 8. A secured lender who obtains a control agreement under Section 8-106(c)(2) can qualify as a protected purchaser of an uncertificated security.

4. This section states directly the rules determining whether one takes free from adverse claims without using the phrase "good faith." Whether a person who takes under suspicious circumstances is disqualified is determined by the rules of Section 8-105 on notice of adverse claims. The term "protected purchaser," which replaces the term "bona fide purchaser" used in the prior version of Article 8, is derived from the term "protected holder" used in the Convention on International Bills and Notes prepared by the United Nations Commission on International Trade Law ("UNCITRAL").

Definitional Cross References:

"Adverse claim"	Section 8-102(a)(1).
"Certificated security"	Section 8-102(a)(4).
"Control"	Section 8-106.
"Notice of adverse claim"	Section 8-105.
"Purchaser"	Sections 1-201(33) & 8-116.
"Uncertificated security"	Section 8-102(a)(18).
"Value"	Sections 1-201(44) & 8-116.

§ 25-8-304. Indorsement.

(a) An indorsement may be in blank or special. An indorsement in blank includes an indorsement to bearer. A special indorsement specifies to whom a security is to be transferred or who has power to transfer it. A holder may convert a blank indorsement to a special indorsement.

(b) An indorsement purporting to be only part of a security certificate representing units intended by the issuer to be separately transferable is effective to the extent of the indorsement.

(c) An indorsement, whether special or in blank, does not constitute a transfer until delivery of the certificate on which it appears or, if the indorsement is on a separate document, until delivery of both the document and the certificate.

(d) If a security certificate in registered form has been delivered to a purchaser without a necessary indorsement, the purchaser may become a protected purchaser only when the indorsement is supplied. However, against a transferor, a transfer is complete upon delivery and the purchaser has a specifically enforceable right to have any necessary indorsement supplied.

(e) An indorsement of a security certificate in bearer form may give notice of an adverse claim to the certificate, but it does not otherwise affect a right to registration that the holder possesses.

(f) Unless otherwise agreed, a person making an indorsement assumes only the obligations provided in G.S. 25-8-108 and not an obligation that the security will be honored by the issuer. (1899, c. 733, ss. 37, 56; Rev., ss. 2186, 2205; C.S., ss. 3018, 3037; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. By virtue of the definition of indorsement in Section 8-102 and the rules of this section, the simplified method of indorsing certificated securities previously set forth in the Uniform Stock Transfer Act is continued. Although more than one special indorsement on a given security certificate is possible, the desire for dividends or interest, as the case may be, should operate to bring the certificate home for registration of transfer within a reasonable period of time. The usual form of assignment which appears in the back of a stock certificate or in a separate "power" may be filled up either in the form of an assignment, a power of attorney to transfer, or both. If it is not filled up at all but merely signed, the indorsement is in blank. If filled up either as an assignment or as a power of attorney to transfer, the indorsement is special.

2. Subsection (b) recognizes the validity of a "partial" indorsement, e.g., as to fifty shares of the one hundred represented by a single certificate. The rights of a transferee under a partial indorsement to the status of a protected purchaser are left to the case law.

3. Subsection (c) deals with the effect of an indorsement without delivery. There must be a voluntary parting with control in order to effect a valid transfer of a certificated security as between the parties. *Levey v. Nason,* 279 Mass. 268, 181 N.E. 193 (1932), and *National Surety Co. v. Indemnity Insurance Co. of North America,* 237 App.Div. 485, 261 N.Y.S. 605 (1933). The provision in Section 10 of the Uniform Stock Transfer Act that an attempted transfer without delivery amounts to a promise to transfer is omitted. Even under that Act the effect of such a promise was left to the applicable law of contracts, and this article by making no reference to such situations intends to achieve a similar result. With respect to delivery there is no counterpart to subsection (d) on right to compel indorsement, such as is envisaged in *Johnson v. Johnson,* 300 Mass. 24, 13 N.E.2d 788 (1938), where the transferee under a written assignment was given the right to compel a transfer of the certificate.

4. Subsection (d) deals with the effect of delivery without indorsement. As between the parties the transfer is made

complete upon delivery, but the transferee cannot become a protected purchaser until indorsement is made. The indorsement does not operate retroactively, and notice may intervene between delivery and indorsement so as to prevent the transferee from becoming a protected purchaser. Although a purchaser taking without a necessary indorsement may be subject to claims of ownership, any issuer's defense of which the purchaser had no notice at the time of delivery will be cut off, since the provisions of this Article protect all purchasers for value without notice (Section 8-202).

The transferee's right to compel an indorsement where a security certificate has been delivered with intent to transfer is recognized in the case law. See *Coats v. Guaranty Bank & Trust Co.,* 170 La. 871, 129 So. 513 (1930). A proper indorsement is one of the requisites of transfer which a purchaser of a certificated security has a right to obtain (Section 8-307). A purchaser may not only compel an indorsement under that section but may also recover for any reasonable expense incurred by the transferor's failure to respond to the demand for an indorsement.

5. Subsection (e) deals with the significance of an indorsement on a security certificate in bearer form. The concept of indorsement applies only to registered securities. A purported indorsement of bearer paper is normally of no effect. An indorsement "for collection," "for surrender" or the like, charges a purchaser with notice of adverse claims (Section 8-105(d)) but does not operate beyond this to interfere with any right the holder may otherwise possess to have the security registered.

6. Subsection (f) makes clear that the indorser of a security certificate does not warrant that the issuer will honor the underlying obligation. In view of the nature of investment securities and the circumstances under which they are normally transferred, a transferor cannot be held to warrant as to the issuer's actions. As a transferor the indorser, of course, remains liable for breach of the warranties set forth in this Article (Section 8-108).

Definitional Cross References:

"Bearer form" Section 8-102(a)(2).

"Certificated security" Section 8-102(a)(4).

"Indorsement" Section 8-102(a)(11).

"Purchaser" Sections 1-201(33) & 8-116.

"Registered form" Section 8-102(a)(13).

"Security certificate" Section 8-102(a)(16).

§ 25-8-305. Instruction.

(a) If an instruction has been originated by an appropriate person but is incomplete in any other respect, any person may complete it as authorized and the issuer may rely on it as completed, even though it has been completed incorrectly.

(b) Unless otherwise agreed, a person initiating an instruction assumes only the obligations imposed by G.S. 25-8-108 and not an obligation that the security will be honored by the issuer. (1899, c. 733, ss. 52, 53; Rev., ss. 2201, 2202; C.S., ss. 3033, 3034; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. The term instruction is defined in Section 8-102(a)(12) as a notification communicated to the issuer of an uncertificated security directing that transfer be registered. Section 8-107 specifies who may initiate an effective instruction.

Functionally, presentation of an instruction is quite similar to the presentation of an indorsed certificate for reregistration. Note that instruction is defined in terms of "communicate," see Section 8-102(a)(6). Thus, the instruction may be in the form of a writing signed by the registered owner or in any other form agreed upon by the issuer and the registered owner. Allowing nonwritten forms of instructions will permit the development and employment of means of transmitting instructions electronically.

When a person who originates an instruction leaves a blank and the blank later is completed, subsection (a) gives the issuer the same rights it would have had against the originating person had that person completed the blank. This is true regardless of whether the person completing the instruction had authority to complete it. Compare Section 8-206 and its comment, dealing with blanks left upon issue.

2. Subsection (b) makes clear that the originator of an instruction, like the indorser of a security certificate, does not warrant that the issuer will honor the underlying obligation, but does make warranties as a transferor under Section 8-108.

Definitional Cross References:

"Appropriate person"	Section 8-107.
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.

§ 25-8-306. Effect of guaranteeing signature, indorsement, or instruction.

(a) A person who guarantees a signature of an indorser of a security certificate warrants that at the time of signing:

(1) The signature was genuine;

(2) The signer was an appropriate person to indorse, or if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person; and

(3) The signer had legal capacity to sign.

(b) A person who guarantees a signature of the originator of an instruction warrants that at the time of signing:

(1) The signature was genuine;

(2) The signer was an appropriate person to originate the instruction, or if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person, if the person specified in the instruction as the registered owner was, in fact, the registered owner, as to which fact the signature guarantor does not make a warranty; and

(3) The signer had legal capacity to sign.

(c) A person who specially guarantees the signature of an originator of an instruction makes the warranties of a signature guarantor under subsection (b) of this section and also warrants that at the time the instruction is presented to the issuer:

(1) The person specified in the instruction as the registered owner of the uncertificated security will be the registered owner; and

(2) The transfer of the uncertificated security requested in the instruction will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction.

(d) A guarantor under subsections (a) and (b) of this section or a special guarantor under subsection (c) of this section does not otherwise warrant the rightfulness of the transfer.

(e) A person who guarantees an indorsement of a security certificate makes the warranties of a signature guarantor under subsection (a) of this section and also warrants the rightfulness of the transfer in all respects.

(f) A person who guarantees an instruction requesting the transfer of an uncertificated security makes the warranties of a special signature guarantor under subsection (c) of this section and also warrants the rightfulness of the transfer in all respects.

(g) An issuer may not require a special guaranty of signature, a guaranty of indorsement, or a guaranty of instruction as a condition to registration of transfer.

(h) The warranties under this section are made to a person taking or dealing with the security in reliance on the guaranty, and the guarantor is liable to the person for loss resulting from their breach.

An indorser or originator of an instruction whose signature, indorsement, or instruction has been guaranteed is liable to a guarantor for any loss suffered by the guarantor as a result of breach of the warranties of the guarantor. (1899, c. 733, ss. 65 to 67, 69; Rev., ss. 2214 to 2216, 2218; C.S., ss. 3046 to 3048, 3050; 1941, c. 353, ss. 11, 12; G.S., ss. 55-91, 55-92; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) provides that a guarantor of the signature of the indorser of a security certificate warrants that the signature is genuine, that the signer is an appropriate person or has actual authority to indorse on behalf of the appropriate person, and that the signer has legal capacity. Subsection (b) provides similar, though not identical, warranties for the guarantor of a signature of the originator of an instruction for transfer of an uncertificated security.

Appropriate person is defined in Section 8-107(a) to include a successor or person who has power under other law to act for a person who is deceased or lacks capacity. Thus if a certificate registered in the name of Mary Roe is indorsed by Jane Doe as executor of Mary Roe, a guarantor of the signature of Jane Doe warrants that she has power to act as executor.

Although the definition of appropriate person in Section 8-107(a) does not itself include an agent, an indorsement by an agent is effective under Section 8-107(b) if the agent has authority to act for the appropriate person. Accordingly, this section provides an explicit warranty of authority for agents.

2. The rationale of the principle that a signature guarantor warrants the authority of the signer, rather than simply the genuineness of the signature, was explained in the leading case of *Jennie Clarkson Home for Children v. Missouri, K. & T. R. Co.,* 182 N.Y. 47, 74 N.E. 571, 70 A.L.R. 787 (1905), which dealt with a guaranty of the signature of a person indorsing on behalf of a corporation. "If stock is held by an individual who is executing a power of attorney for its transfer, the member of the exchange who signs as a witness thereto guaranties not only the genuineness of the signature affixed to the power of attorney, but that the person signing is the individual in whose name the stock stands. With reference to stock standing in the name of a corporation, which can only sign a power of attorney through its authorized officers or agents, a different situation is presented. If the witnessing of the signature of the corporation is only that of the signature of a person who signs for the corporation, then the guaranty is of no value, and there is nothing to protect purchasers or the companies who are called upon to issue new stock in the place of that transferred from the frauds of persons who have signed the names of corporations without authority. If such is the only effect of the guaranty, purchasers and transfer agents must first go to the corporation in whose name the stock stands and ascertain whether the individual who signed the power of attorney had authority to so do. This will require time, and in many cases will necessitate the postponement of the completion of the purchase by the payment of the money until the facts can be ascertained. The broker who is acting for the owner has an opportunity to become acquainted with his customer, and may readily before sale ascertain, in case of a corporation, the name of the officer who is authorized to execute the power of attorney. It was therefore, we think, the purpose of the rule to cast upon the broker who witnesses the signature the duty of ascertaining whether the person signing the name of the corporation had authority to so do, and making the witness a guarantor that it is the signature of the corporation in whose name the stock stands."

3. Subsection (b) sets forth the warranties that can reasonably be expected from the guarantor of the signature of the originator of an instruction, who, though familiar with the signer, does not have any evidence that the purported owner is in fact the owner of the subject uncertificated security. This is in contrast to the position of the person guaranteeing a signature on a certificate who can see a certificate in the signer's possession in the name of or indorsed to the signer or in blank. Thus, the warranty in paragraph (2) of subsection (b) is expressly conditioned on the actual registration's conforming to that represented by the originator. If the signer purports

to be the owner, the guarantor under paragraph (2), warrants only the identity of the signer. If, however, the signer is acting in a representative capacity, the guarantor warrants both the signer's identity and authority to act for the purported owner. The issuer needs no warranty as to the facts of registration because those facts can be ascertained from the issuer's own records.

4. Subsection (c) sets forth a "special guaranty of signature" under which the guarantor additionally warrants both registered ownership and freedom from undisclosed defects of record. The guarantor of the signature of an indorser of a security certificate effectively makes these warranties to a purchaser for value on the evidence of a clean certificate issued in the name of the indorser, indorsed to the indorser, or indorsed in blank. By specially guaranteeing under subsection (c), the guarantor warrants that the instruction will, when presented to the issuer, result in the requested registration free from defects not specified.

5. Subsection (d) makes clear that the warranties of a signature guarantor are limited to those specified in this section and do not include a general warranty of rightfulness. On the other hand subsections (e) and (f) provide that a person guaranteeing an indorsement or an instruction does warrant that the transfer is rightful in all respects.

6. Subsection (g) makes clear what can be inferred from the combination of Sections 8-401 and 8-402, that the issuer may not require as a condition to transfer a guaranty of the indorsement or instruction nor may it require a special signature guaranty.

7. Subsection (h) specifies to whom the warranties in this section run, and also provides that a person who gives a guaranty under this section has an action against the indorser or originator for any loss suffered by the guarantor.

Definitional Cross References:

"Appropriate person"	Section 8-107.
"Genuine"	Section 1-201(18).
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.
"Security certificate"	Section 8-102(a)(16).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-307. Purchaser's right to requisites for registration of transfer.

Unless otherwise agreed, the transferor of a security on due demand shall supply the purchaser with proof of authority to transfer or with any other requisite necessary to obtain registration of the transfer of the security, but if the transfer is not for value, a transferor need not comply unless the purchaser pays the necessary expenses. If the transferor fails within a reasonable time to comply with the demand, the purchaser may reject or rescind the transfer. (1899, c. 733, s. 49; Rev., s. 2198; C.S., s. 3030; 1941, c. 353, s. 9; G.S., s. 55-89; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Because registration of the transfer of a security is a matter of vital importance, a purchaser is here provided with the means of obtaining such formal requirements for registration as signature guaranties, proof of authority, transfer tax stamps, and the like. The transferor is the one in a position to supply most conveniently whatever documentation may be requisite for registration of transfer, and the duty to do so upon demand within a reasonable time is here stated affirmatively. If an essential item is peculiarly within the province of the transferor so that the transferor is the only one who can obtain it, the purchaser may specifically enforce the right to obtain it. Compare Section 8-304(d). If a transfer is not for value the transferee need not pay expenses.

2. If the transferor's duty is not performed the transferee may reject or rescind the contract to transfer. The transferee is not bound to do so. An action for

damages for breach of contract may be preferred.

Definitional Cross References:

"Purchaser" Sections 1-201(33) & 8-116.

"Security" Section 8-102(a)(15).

"Value" Sections 1-201(44) & 8-116.

PART 4.

REGISTRATION.

§ 25-8-401. Duty of issuer to register transfer.

(a) If a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security, the issuer shall register the transfer as requested if:

(1) Under the terms of the security the person seeking registration of transfer is eligible to have the security registered in its name;

(2) The indorsement or instruction is made by the appropriate person or by an agent who has actual authority to act on behalf of the appropriate person;

(3) Reasonable assurance is given that the indorsement or instruction is genuine and authorized (G.S. 25-8-402);

(4) Any applicable law relating to the collection of taxes has been complied with;

(5) The transfer does not violate any restriction on transfer imposed by the issuer in accordance with G.S. 25-8-204;

(6) A demand that the issuer not register transfer has not become effective under G.S. 25-8-403, or the issuer has complied with G.S. 25-8-403(b) but no legal process or indemnity bond is obtained as provided in G.S. 25-8-403(d); and

(7) The transfer is in fact rightful or is to a protected purchaser.

(b) If an issuer is under a duty to register a transfer of a security, the issuer is liable to a person presenting a certificated security or an instruction for registration or to the person's principal for loss resulting from unreasonable delay in registration or failure or refusal to register the transfer. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. This section states the duty of the issuer to register transfers. A duty exists only if certain preconditions exist. If any of the preconditions do not exist, there is no duty to register transfer. If an indorsement on a security certificate is a forgery, there is no duty. If an instruction to transfer an uncertificated security is not originated by an appropriate person, there is no duty. If there has not been compliance with applicable tax laws, there is no duty. If a security certificate is properly indorsed but nevertheless the transfer is in fact wrongful, there is no duty unless the transfer is to a protected purchaser (and the other preconditions exist).

This section does not constitute a mandate that the issuer must establish that all preconditions are met before the issuer registers a transfer. The issuer may waive the reasonable assurances specified in paragraph (a)(3). If it has confidence in the responsibility of the persons requesting transfer, it may ignore questions of compliance with tax laws. Although an issuer has no duty if the transfer is wrongful, the issuer has no duty to inquire into adverse claims, see Section 8-404.

2. By subsection (b) the person entitled to registration may not only compel it but may hold the issuer liable in damages for unreasonable delay.

3. Section 8-201(c) provides that with respect to registration of transfer, "issuer" means the person on whose behalf transfer books are maintained. Transfer agents, registrars or the like within the scope of their respective functions have rights and duties under this part similar to those of the issuer. See Section 8-407.

Definitional Cross References:

"Appropriate person"	Section 8-107.
"Certificated security"	Section 8-102(a)(4).
"Genuine"	Section 1-201(18).
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.
"Protected purchaser"	Section 8-303.
"Registered form"	Section 8-102(a)(13).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-402. Assurance that indorsement or instruction is effective.

(a) An issuer may require the following assurance that each necessary indorsement or each instruction is genuine and authorized:

(1) In all cases, a guaranty of the signature of the person making an indorsement or originating an instruction including, in the case of an instruction, reasonable assurance of identity;

(2) If the indorsement is made or the instruction is originated by an agent, appropriate assurance of actual authority to sign;

(3) If the indorsement is made or the instruction is originated by a fiduciary pursuant to G.S. 25-8-107(a)(4) or G.S. 25-8-107(a)(5), appropriate evidence of appointment or incumbency;

(4) If there is more than one fiduciary, reasonable assurance that all who are required to sign have done so; and

(5) If the indorsement is made or the instruction is originated by a person not covered by another provision of this subsection, assurance appropriate to the case corresponding as nearly as may be to the provisions of this subsection.

(b) An issuer may elect to require reasonable assurance beyond that specified in this section.

(c) In this section:

(1) "Guaranty of the signature" means a guaranty signed by or on behalf of a person reasonably believed by the issuer to be responsible. An issuer may adopt standards with respect to responsibility if they are not manifestly unreasonable.

(2) "Appropriate evidence of appointment or incumbency" means:

(i) In the case of a fiduciary appointed or qualified by a court, a certificate issued by or under the direction or supervision of the court or an officer thereof and dated within 60 days before the date of presentation for transfer; or

(ii) In any other case, a copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by an issuer to be responsible or, in the absence of that document or certificate, other evidence the issuer reasonably considers appropriate. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. An issuer is absolutely liable for wrongful registration of transfer if the indorsement or instruction is ineffective. See Section 8-404. Accordingly, an issuer is entitled to require such assurance as is reasonable under the circumstances that all necessary indorsements are effective, and thus to minimize its risk. This section establishes the requirements the issuer may make in terms of documentation which, except in the rarest of instances, should be easily furnished. Subsection (b) provides that an issuer may require additional assurances if that requirement is reasonable under the circumstances, but if the issuer demands more than reasonable assurance that the instruction or the necessary indorsements are genuine and authorized, the presenter may refuse the demand and sue for improper refusal to register. Section 8-401(b).

2. Under subsection (a)(1), the issuer may require in all cases a guaranty of signature. See Section 8-306. When an instruction is presented the issuer always may require reasonable assurance as to the identity of the originator. Subsection (c) allows the issuer to require that the person making these guaranties be one reasonably believed to be responsible, and the issuer may adopt standards of responsibility which are not manifestly unreasonable. Regulations under the federal securities laws, however, place limits on the requirements transfer agents may impose concerning the responsibility of eligible signature guarantors. See 17 C.F.R. 240.17Ad-15.

3. This section, by paragraphs (2) through (5) of subsection (a), permits the issuer to seek confirmation that the indorsement or instruction is genuine and authorized. The permitted methods act as a double check on matters which are within the warranties of the signature guarantor. See Section 8-306. Thus, an agent may be required to submit a power of attorney, a corporation to submit a certified resolution evidencing the authority of its signing officer to sign, an executor or administrator to submit the usual "short-form certificate," etc. But failure of a fiduciary to obtain court approval of the transfer or to comply with other requirements does not make the fiduciary's signature ineffective. Section 8-107(c). Hence court orders and other controlling instruments are omitted from subsection (a).

Subsection (a)(3) authorizes the issuer to require "appropriate evidence" of appointment or incumbency, and subsection (c) indicates what evidence will be "appropriate". In the case of a fiduciary appointed or qualified by a court that evidence will be a court certificate dated within sixty days before the date of presentation, subsection (c)(2)(i). Where the fiduciary is not appointed or qualified by a court, as in the case of a successor trustee, subsection (c)(2)(ii) applies. In that case, the issuer may require a copy of a trust instrument or other document showing the appointment, or it may require the certificate of a responsible person. In the absence of such a document or certificate, it may require other appropriate evidence. If the security is registered in the name of the fiduciary as such, the person's signature is effective even though the person is no longer serving in that capacity, see Section 8-107(d), hence no evidence of incumbency is needed.

4. Circumstances may indicate that a necessary signature was unauthorized or was not that of an appropriate person. Such circumstances would be ignored at risk of absolute liability. To minimize that risk the issuer may properly exercise the option given by subsection (b) to require assurance beyond that specified in subsection (a). On the other hand, the facts at hand may reflect only on the rightfulness of the transfer. Such facts do not create a duty of inquiry, because the issuer is not liable to an adverse claimant unless the claimant obtains legal process. See Section 8-404.

Definitional Cross References:

"Appropriate person"	Section 8-107.
"Genuine"	Section 1-201(18).
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.

§ 25-8-403. Demand that issuer not register transfer.

(a) A person who is an appropriate person to make an indorsement or originate an instruction may demand that the issuer not register transfer of a security by communicating to the issuer a notification that identifies the registered owner and the issue of which the security is a part and provides an address for communications directed to the person making the demand. The demand is effective only if it is received by the issuer at a time and in a manner affording the issuer reasonable opportunity to act on it.

(b) If a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security after a demand that the issuer not register transfer has become effective, the issuer shall promptly communicate to (i) the person who initiated the demand at the address provided in the demand and (ii) the person who presented the security for registration of transfer or initiated the instruction requesting registration of transfer a notification stating that:

(1) The certificated security has been presented for registration of transfer or the instruction for registration of transfer of the uncertificated security has been received;

(2) A demand that the issuer not register transfer had previously been received; and

(3) The issuer will withhold registration of transfer for a period of time stated in the notification in order to provide the person who initiated the demand an opportunity to obtain legal process or an indemnity bond.

(c) The period described in subdivision (b)(3) of this section may not exceed 30 days after the date of communication of the notification. A shorter period may be specified by the issuer if it is not manifestly unreasonable.

(d) An issuer is not liable to a person who initiated a demand that the issuer not register transfer for any loss the person suffers as a result of registration of a transfer pursuant to an effective indorsement or instruction if the person who initiated the demand does not, within the time stated in the issuer's communication, either:

(1) Obtain an appropriate restraining order, injunction, or other process from a court of competent jurisdiction enjoining the issuer from registering the transfer; or

(2) File with the issuer an indemnity bond, sufficient in the issuer's judgment to protect the issuer and any transfer agent, registrar, or other agent of the issuer involved from any loss it or they may suffer by refusing to register the transfer.

(e) This section does not relieve an issuer from liability for registering transfer pursuant to an indorsement or instruction that was not effective. (1965, c. 700, s. 1; 1977, c. 814, s. 9; 1989, c. 588, s. 1; 1989 (Reg. Sess., 1990), c. 1024, s. 9(d); 1997-181, s. 1.)

OFFICIAL COMMENT

1. The general rule under this article is that if there has been an effective indorsement or instruction, a person who contends that registration of the transfer would be wrongful should not be able to interfere with the registration process merely by sending notice of the assertion to the issuer. Rather, the claimant must obtain legal process. See Section 8-404. Section 8-403 is an exception to this general rule. It permits the registered owner — but not third parties — to demand that the issuer not register a transfer.

2. This section is intended to alleviate the problems faced by registered owners of certificated securities who lose or misplace their certificates. A registered owner who realizes that a certificate may have been lost or stolen should promptly report that fact to the issuer, lest the owner be precluded from asserting a claim for wrongful registration. See Section 8-406. The usual practice of issuers and transfer agents is that when a certificate is reported as lost, the owner is notified that a replacement can be obtained if the owner provides an indemnity bond. See Section 8-405. If the registered owner does not plan to transfer the securities, the owner might choose not to obtain a replacement, particularly if the owner suspects that the certificate has merely been misplaced.

Under this section, the owner's notification that the certificate has been lost would constitute a demand that the issuer not register transfer. No indemnity bond or legal process is necessary. If the original certificate is presented for registration of transfer, the issuer is required to notify the registered owner of that fact, and defer registration of transfer for a stated period. In order to prevent undue delay in the process of registration, the stated period may not exceed thirty days. This gives the registered owner an opportunity to either obtain legal process or post an indemnity bond and thereby prevent the issuer from registering transfer.

3. Subsection (e) makes clear that this section does not relieve an issuer from liability for registering a transfer pursuant to an ineffective indorsement. An issuer's liability for wrongful registration in such cases does not depend on the presence or absence of notice that the indorsement was ineffective. Registered owners who are confident that they neither indorsed the certificates, nor did anything that would preclude them from denying the effectiveness of another's indorsement, see Sections 8-107(b) and 8-406, might prefer to pursue their rights against the issuer for wrongful registration rather than take advantage of the opportunity to post a bond or seek a restraining order when notified by the issuer under this section that their lost certificates have been presented for registration in apparently good order.

Definitional Cross References:

"Appropriate person"	Section 8-107.
"Certificated security"	Section 8-102(a)(4).
"Communicate"	Section 8-102(a)(6).
"Effective"	Section 8-107.
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.
"Registered form"	Section 8-102(a)(13).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-404. Wrongful registration.

(a) Except as otherwise provided in G.S. 25-8-406, an issuer is liable for wrongful registration of transfer if the issuer has registered a transfer of a security to a person not entitled to it, and the transfer was registered:

(1) Pursuant to an ineffective indorsement or instruction;

(2) After a demand that the issuer not register transfer became effective under G.S. 25-8-403(a) and the issuer did not comply with G.S. 25-8-403(b);

(3) After the issuer had been served with an injunction, restraining order, or other legal process enjoining it from registering the transfer, issued by a court of competent jurisdiction, and the issuer had a reasonable opportunity to act on the injunction, restraining order, or other legal process; or

(4) By an issuer acting in collusion with the wrongdoer.

(b) An issuer that is liable for wrongful registration of transfer under subsection (a) of this section on demand shall provide the person entitled to the security with a like certificated or uncertificated security, and any payments or distributions that the person did not receive as a result of the wrongful registration. If an overissue would result, the issuer's liability to provide the person with a like security is governed by G.S. 25-8-210.

(c) Except as otherwise provided in subsection (a) of this section or in a law relating to the collection of taxes, an issuer is not liable to an owner or other person suffering loss as a result of the registration of a transfer of a security if registration was made pursuant to an effective indorsement or instruction. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsection (a)(1) provides that an issuer is liable if it registers transfer pursuant to an indorsement or instruction that was not effective. For example, an issuer that registers transfer on a forged indorsement is liable to the registered owner. The fact that the issuer had no reason to suspect that the indorsement was forged or that the issuer obtained the ordinary assurances under Section 8-402 does not relieve the issuer from liability. The reason that issuers obtain signature guaranties and other assurances is that they are liable for wrongful registration.

Subsection (b) specifies the remedy for wrongful registration. Pre-Code cases established the registered owner's right to receive a new security where the issuer had wrongfully registered a transfer, but some cases also allowed the registered owner to elect between an equitable action to compel issue of a new security and an action for damages. Cf. *Casper v. Kalt-Zimmers Mfg. Co.,* 159 Wis. 517, 149 N.W. 754 (1914). Article 8 does not allow such election. The true owner of a certificated security is required to take a new security except where an overissue would result and a similar security is not reasonably available for purchase. See Section 8-210. The true owner of an uncertificated security is entitled and required to take restoration of the records to their proper state, with a similar exception for overissue.

2. Read together, subsections (a) and (c) have the effect of providing that an issuer has no duties to an adverse claimant unless the claimant serves legal process on the issuer to enjoin registration. Issuers, or their transfer agents, perform a record-keeping function for the direct holding system that is analogous to the functions performed by clearing corporations and securities intermediaries in the indirect holding system. This section applies to the record-keepers for the direct holding system the same standard that Section 8-115 applies to the record-keepers for the indirect holding system. Thus, issuers are not liable to adverse claimants merely on the basis of notice. As in the case of the analogous rules for the indirect holding system, the policy of this section is to protect the right of investors to have their securities transfers processed without the disruption or delay that might result if the record-keepers risked liability to third parties. It would be undesirable to apply different standards to the direct and indirect holding systems, since doing so might operate as a disincentive to the development of a book-entry direct holding system.

3. This section changes prior law under which an issuer could be held liable, even though it registered transfer on an effective indorsement or instruction, if the issuer had in some fashion been notified that the transfer might be wrongful against a third party, and the issuer did not appropriately discharge its duty to inquire into the adverse claim. See Section 8-403 (1978).

The rule of former Section 8-403 was anomalous inasmuch as Section 8-207 provides that the issuer is entitled to "treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner." Under Section 8-207, the fact that a third person notifies the issuer of a claim does not preclude the issuer from treating the registered owner as the person entitled to the security. See *Kerrigan v. American Orthodontics Corp.,* 960 F.2d 43 (7th Cir.

1992). The change made in the present version of Section 8-404 ensures that the rights of registered owners and the duties of issuers with respect to registration of transfer will be protected against third-party interference in the same fashion as other rights of registered ownership.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Effective"	Section 8-107.
"Indorsement"	Section 8-102(a)(11).
"Instruction"	Section 8-102(a)(12).
"Issuer"	Section 8-201.
"Security"	Section 8-102(a)(15).
"Uncertificated security"	Section 8-102(a)(18).

§ 25-8-405. Replacement of lost, destroyed, or wrongfully taken security certificate.

(a) If an owner of a certificated security, whether in registered or bearer form, claims that the certificate has been lost, destroyed, or wrongfully taken, the issuer shall issue a new certificate if the owner:

(1) So requests before the issuer has notice that the certificate has been acquired by a protected purchaser;

(2) Files with the issuer a sufficient indemnity bond; and

(3) Satisfies other reasonable requirements imposed by the issuer.

(b) If, after the issue of a new security certificate, a protected purchaser of the original certificate presents it for registration of transfer, the issuer shall register the transfer unless an overissue would result. In that case, the issuer's liability is governed by G.S. 25-8-210. In addition to any rights on the indemnity bond, an issuer may recover the new certificate from a person to whom it was issued or any person taking under that person, except a protected purchaser. (1941, c. 353, s. 20; G.S., s. 55-100; 1955, c. 1371, s. 2; 1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. This section enables the owner to obtain a replacement of a lost, destroyed, or stolen certificate, provided that reasonable requirements are satisfied and a sufficient indemnity bond supplied.

2. Where an "original" security certificate has reached the hands of a protected purchaser, the registered owner — who was in the best position to prevent the loss, destruction or theft of the security certificate — is now deprived of the new security certificate issued as a replacement. This changes the pre-Uniform Commercial Code law under which the original certificate was ineffective after the issue of a replacement except insofar as it might represent an action for damages in the hands of a purchaser for value without notice. *Keller v. Eureka Brick Mach. Mfg. Co.*, 43 Mo.App. 84, 11 L.R.A. 472 (1890). Where both the original and the new certificate have reached protected purchasers the issuer is required to honor both certificates unless an overissue would result and the security is not reasonably available for purchase. See Section 8-210. In the latter case alone, the protected purchaser of the original certificate is relegated to an action for damages. In either case, the issuer itself may recover on the indemnity bond.

Definitional Cross References:

"Bearer form"	Section 8-102(a)(2).
"Certificated security"	Section 8-102(a)(4).
"Issuer"	Section 8-201.
"Notice"	Section 1-201(25).
"Overissue"	Section 8-210.
"Protected purchaser"	Section 8-303.
"Registered form"	Section 8-102(a)(13).
"Security certificate"	Section 8-102(a)(16).

§ 25-8-406. Obligation to notify issuer of lost, destroyed, or wrongfully taken security certificate.

If a security certificate has been lost, apparently destroyed, or wrongfully taken, and the owner fails to notify the issuer of that fact within a reasonable time after the owner has notice of it and the issuer registers a transfer of the security before receiving notification, the owner may not assert against the issuer a claim for registering the transfer under G.S. 25-8-404 or a claim to a new security certificate under G.S. 25-8-405. (1965, c. 700, s. 1; 1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

An owner who fails to notify the issuer within a reasonable time after the owner knows or has reason to know of the loss or theft of a security certificate is estopped from asserting the ineffectiveness of a forged or unauthorized indorsement and the wrongfulness of the registration of the transfer. If the lost certificate was indorsed by the owner, then the registration of the transfer was not wrongful under Section 8-404, unless the owner made an effective demand that the issuer not register transfer under Section 8-403.

Definitional Cross References:

"Issuer"	Section 8-201.
"Notify"	Section 1-201(25).
"Security certificate"	Section 8-102(a)(16).

§ 25-8-407. Authenticating trustee, transfer agent, and registrar.

A person acting as authenticating trustee, transfer agent, registrar, or other agent for an issuer in the registration of a transfer of its securities, in the issue of new security certificates or uncertificated securities, or in the cancellation of surrendered security certificates has the same obligation to the holder or owner of a certificated or uncertificated security with regard to the particular functions performed as the issuer has in regard to those functions. (1989, c. 588, s. 1; 1997-181, s. 1.)

OFFICIAL COMMENT

1. Transfer agents, registrars, and the like are here expressly held liable both to the issuer and to the owner for wrongful refusal to register a transfer as well as for wrongful registration of a transfer in any case within the scope of their respective functions where the issuer would itself be liable. Those cases which have regarded these parties solely as agents of the issuer and have therefor refused to recognize their liability to the owner for mere nonfeasance, i.e., refusal to register a transfer, are rejected. *Hulse v. Consolidated Quicksilver Mining Corp.,* 65 Idaho 768, 154 P.2d 149 (1944); *Nicholson v. Morgan,* 119 Misc. 309, 196 N.Y.Supp. 147 (1922); *Lewis v. Hargadine-McKittrick Dry Goods Co.,* 305 Mo. 396, 274 S.W. 1041 (1924).

2. The practice frequently followed by authenticating trustees of issuing certificates of indebtedness rather than authenticating duplicate certificates where securities have been lost or stolen became obsolete in view of the provisions of Section 8-405, which makes express provision for the issue of substitute securities. It is not a breach of trust or lack of due diligence for trustees to authenticate new securities. Cf. *Switzerland General Ins. Co. of Zurich v. N.Y.C. & H.R.R. Co.,* 152 App.Div. 70, 136 N.Y.S. 726 (1912).

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4).
"Issuer"	Section 8-201.
"Security"	Section 8-102(a)(15).
"Security certificate"	Section 8-102(a)(16).

"Uncertificated security"	Section 8-102(a)(18).

PART 5

SECURITY ENTITLEMENTS.

§ 25-8-501. Securities account; acquisition of security entitlement from securities intermediary.

(a) "Securities account" means an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset.

(b) Except as otherwise provided in subsections (d) and (e) of this section, a person acquires a security entitlement if a securities intermediary:

(1) Indicates by book entry that a financial asset has been credited to the person's securities account;

(2) Receives a financial asset from the person or acquires a financial asset for the person and, in either case, accepts it for credit to the person's securities account; or

(3) Becomes obligated under other law, regulation, or rule to credit a financial asset to the person's securities account.

(c) If a condition of subsection (b) of this section has been met, a person has a security entitlement even though the securities intermediary does not itself hold the financial asset.

(d) If a securities intermediary holds a financial asset for another person, and the financial asset is registered in the name of, payable to the order of, or specially indorsed to the other person, and has not been indorsed to the securities intermediary or in blank, the other person is treated as holding the financial asset directly rather than as having a security entitlement with respect to the financial asset.

(e) Issuance of a security is not establishment of a security entitlement. (1997-181, s. 1.)

OFFICIAL COMMENT

1. Part 5 rules apply to security entitlements, and Section 8-501(b) provides that a person has a security entitlement when a financial asset has been credited to a "securities account." Thus, the term "securities account" specifies the type of arrangements between institutions and their customers that are covered by Part 5. A securities account is a consensual arrangement in which the intermediary undertakes to treat the customer as entitled to exercise the rights that comprise the financial asset. The consensual aspect is covered by the requirement that the account be established pursuant to agreement. The term agreement is used in the broad sense defined in Section 1-201(3). There is no requirement that a formal or written agreement be signed.

As the securities business is presently conducted, several significant relationships clearly fall within the definition of a securities account, including the relationship between a clearing corporation and its participants, a broker and customers who leave securities with the broker, and a bank acting as securities custodian and its custodial customers. Given the enormous variety of arrangements concerning securities that exist today, and the certainty that new arrangements will evolve in the future, it is not possible to specify all of the arrangements to which the term does and does not apply.

Whether an arrangement between a firm and another person concerning a security or other financial asset is a "securities account" under this Article depends on whether the firm has undertaken to treat the other person as entitled to exercise the rights that comprise the security or other financial asset. Section 1-102, however, states the fundamental principle of interpretation that the Code provisions should be construed and applied to promote their underlying purposes and policies. Thus, the question whether a given arrangement is a securities account should be decided not by dictionary analysis of the words of the definition taken out of context, but by considering whether it promotes the objectives of Article 8 to include the arrangement within the term securities account.

The effect of concluding that an arrangement is a securities account is that the rules of Part 5 apply. Accordingly, the definition of "securities account" must be interpreted in light of the substantive provisions in Part 5, which describe the core features of the type of relationship for which the commercial law rules of Revised Article 8 concerning security entitlements were designed. There are many arrangements between institutions and other persons concerning securities or other financial assets which do not fall within the definition of "securities account" because the institutions have not undertaken to treat the other persons as entitled to exercise the ordinary rights of an entitlement holder specified in the Part 5 rules. For example, the term securities account does not cover the relationship between a bank and its depositors or the relationship between a trustee and the beneficiary of an ordinary trust, because those are not relationships in which the holder of a financial asset has undertaken to treat the other as entitled to exercise the rights that comprise the financial asset in the fashion contemplated by the Part 5 rules.

In short, the primary factor in deciding whether an arrangement is a securities account is whether application of the Part 5 rules is consistent with the expectations of the parties to the relationship. Relationships not governed by Part 5 may be governed by other parts of Article 8 if the relationship gives rise to a new security, or may be governed by other law entirely.

2. Subsection (b) of this section specifies what circumstances give rise to security entitlements. Paragraph (1) of subsection (b) sets out the most important rule. It turns on the intermediary's conduct, reflecting a basic operating assumption of the indirect holding system that once a securities intermediary has acknowledged that it is carrying a position in a financial asset for its customer or participant, the intermediary is obligated to treat the customer or participant as entitled to the financial asset. Paragraph (1) does not attempt to specify exactly what accounting, record-keeping, or information transmission steps suffice to indicate that the intermediary has credited the account. That is left to agreement, trade practice, or rule in order to provide the flexibility necessary to accommodate varying or changing accounting and information processing systems. The point of paragraph (1) is that once an intermediary has acknowledged that it is carrying a position for the customer or participant, the customer or participant has a security entitlement. The precise form in which the intermediary manifests that acknowledgment is left to private ordering.

Paragraph (2) of subsection (b) sets out a different operational test, turning not on the intermediary's accounting system but on the facts that accounting systems are supposed to represent. Under paragraph (b)(2) a person has a security entitlement if the intermediary has received and accepted a financial asset for credit to the account of its customer or participant. For example, if a customer of a broker or bank custodian delivers a security certificate in proper form to the broker or bank to be held in the customer's account, the customer acquires a security entitlement. Paragraph (b)(2) also covers circumstances in which the intermediary receives a financial asset from a third person for credit to the account of the customer or participant. Paragraph (b)(2) is not limited to circumstances in which the intermediary receives security certificates or other financial assets in physical form. Paragraph (b)(2) also covers circumstances in which the intermediary acquires a security entitlement with respect to a financial asset which is to be credited to the account of the intermediary's own customer. For example, if a customer transfers her account from Broker A to Broker B, she acquires security entitlements against Broker B once the clearing corporation has credited the positions to Broker B's account. It should be noted, however, that paragraph (b)(2) provides that a person acquires a security entitlement when the intermediary not only receives but also accepts the financial asset for credit to the account. This limitation is included to take account of the fact that there may be circumstances in which an intermediary has received a financial asset but is not willing to undertake the obligations that flow from establishing a security entitlement. For example, a security certificate which is sent to an intermediary may not be in proper form, or may represent a type of financial asset which the intermediary is not willing to carry for others. It should be noted that in all but extremely unusual cases, the circumstances covered by paragraph (2) will also be covered by paragraph (1), because the intermediary will have credited the positions to the customer's account.

Paragraph (3) of subsection (b) sets out a residual test, to avoid any implication that the failure of an intermediary to make the appropriate entries to credit a position to a customer's securities account would prevent the customer from acquiring the rights of an entitlement holder under Part 5. As is the case with the paragraph (2) test, the paragraph (3) test would not be needed for the ordinary cases, since they are covered by paragraph (1).

3. In a sense, Section 8-501(b) is analogous to the rules set out in the provisions of Sections 8-313(1)(d) and 8-320 of the prior version of Article 8 that specified what acts by a securities intermediary or clearing corporation sufficed as a transfer of securities held in fungible bulk. Unlike the prior version of Article 8, however, this section is not based on the idea that an entitlement holder acquires rights only by virtue of a "transfer" from the securities intermediary to the entitlement holder. In the indirect holding system, the significant fact is that the securities intermediary has undertaken to treat the customer as entitled to the financial asset. It is up to the securities intermediary to take the necessary steps to ensure that it will be able to perform its undertaking. It is, for example, entirely possible that a securities intermediary might make entries in a customer's account reflecting that customer's acquisition of a certain security at a time when the securities intermediary did not itself happen to hold any units of that security. The person from whom the securities intermediary bought the security might have failed to deliver and it might have taken some time to clear up the problem, or there may have been an operational gap in time between the crediting of a customer's account and the receipt of securities from another securities intermediary. The entitlement holder's rights against the securities intermediary do not depend on whether or when the securities intermediary acquired its interests. Subsection (c) is intended to make this point clear. Subsection (c) does not mean that the intermediary is free to create security entitlements without itself holding sufficient financial assets to satisfy its entitlement holders. The duty of a securities intermediary to maintain sufficient assets is governed by Section 8-504 and regulatory law. Subsection (c) is included only to make it clear the question whether a person has acquired a security entitlement does not depend on whether the intermediary has complied with that duty.

4. Part 5 of Article 8 sets out a carefully designed system of rules for the indirect holding system. Persons who hold securities through brokers or custodians have security entitlements that are governed by Part 5, rather than being treated as the direct holders of securities. Subsection (d) specifies the limited circumstance in which a customer who leaves a financial asset with a broker or other securities intermediary has a direct interest in the financial asset, rather than a security entitlement.

The customer can be a direct holder only if the security certificate, or other financial asset, is registered in the name of, payable to the order of, or specially indorsed to the customer, and has not been indorsed by the customer to the securities intermediary or in blank. The distinction between those circumstances where the customer can be treated as direct owner and those where the customer has a security entitlement is essentially the same as the distinction drawn under the federal bankruptcy code between customer name securities and customer property. The distinction does not turn on any form of physical identification or segregation. A customer who delivers certificates to a broker with blank indorsements or stock powers is not a direct holder but has a security entitlement, even though the broker holds those certificates in some form of separate safe-keeping arrangement for that particular customer. The customer remains the direct holder only if there is no indorsement or stock power so that further action by the customer is required to place the certificates in a form where they can be transferred by the broker.

The rule of subsection (d) corresponds to the rule set out in Section 8-301(a)(3) specifying when acquisition of possession of a certificate by a securities intermediary counts as "delivery" to the customer.

5. Subsection (e) is intended to make clear that Part 5 does not apply to an arrangement in which a security is issued representing an interest in underlying assets, as distinguished from arrangements in which the underlying assets are carried in a securities account. A common mechanism by which new financial instruments are devised is that a financial institution that holds some security, financial instrument, or pool thereof, creates interests in that asset or pool which are sold to others. In many such cases, the interests so created will fall within the definition of "security" in Section 8-102(a)(15). If so, then by virtue of subsection (e) of Section 8-501, the relationship between the institution that creates the interests and the persons who hold them is not a security entitlement to which the Part 5 rules apply. Accordingly, an arrangement such as an American depositary receipt facility which creates freely transferable interests in underlying securities will be issuance of a security under Article 8 rather than establishment of a security entitlement to the underlying securities.

The subsection (e) rule can be regarded as an aspect of the definitional rules specifying the meaning of securities account and security entitlement. Among the key components of the definition of security in Section 8-102(a)(15) are the "transferability" and "divisibility" tests. Securities, in the Article 8 sense, are fungible interests or obligations that are intended to be tradable. The concept of security entitlement under Part 5 is quite different. A security entitlement is the package of rights that a person has against the person's own intermediary with respect to the positions carried in the person's securities account. That package of rights is not, as such, something that is traded. When a customer sells a security that he or she had held through a securities account, her security entitlement is terminated; when she buys a security that she will hold through her securities account, she acquires a security entitlement. In most cases, settlement of a securities trade will involve termination of one person's security entitlement and acquisition of a security entitlement by another person. That transaction, however, is not a "transfer" of the same entitlement from one person to another. That is not to say that an entitlement holder cannot transfer an interest in her security entitlement as such; granting a security interest in a security entitlement is such a transfer. On the other hand, the nature of a security entitlement is that the intermediary is undertaking duties only to the person identified as the entitlement holder.

Definitional Cross References:

"Financial asset" Section 8-102(a)(9).
"Indorsement" Section 8-102(a)(11).
"Securities intermediary" Section 8-102(a)(14).
"Security" Section 8-102(a)(15).
"Security entitlement" Section 8-102(a)(17).

Editor's Note. — Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

§ 25-8-502. Assertion of adverse claim against entitlement holder.

An action based on an adverse claim to a financial asset, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who acquires a security entitlement under G.S. 25-8-501 for value and without notice of the adverse claim. (1997-181, s. 1.)

OFFICIAL COMMENT

1. This section provides investors in the indirect holding system with protection against adverse claims by specifying that no adverse claim can be asserted against a person who acquires a security entitlement under Section 8-501 for value and without notice of the adverse claim. It plays a role in the indirect holding system analogous to the rule of the direct holding system that protected purchasers take free from adverse claims (Section 8-303).

This section does not use the locution "takes free from adverse claims" because that could be confusing as applied to the indirect holding system. The nature of the indirect holding system is that an entitlement holder has an interest in common with others who hold positions in the same financial asset through the same intermediary. Thus, a particular entitlement holder's interest in the financial assets held by its intermediary is necessarily "subject to" the interests of others. See Section 8-503. The rule stated in this section might have been expressed by saying that a person who acquires a security entitlement under Section 8-501 for value and without notice of adverse claims takes "that security entitlement" free from adverse claims. That formulation has not been used, however, for fear that it would be misinterpreted as suggesting that the person acquires a right to the underlying financial assets that could not be affected by the competing rights of others claiming through common or higher tier intermediaries. A security entitlement is a complex bundle of rights. This section does not deal with the question of what rights are in the bundle. Rather, this section provides that once a person has acquired the bundle, someone else cannot take it away on the basis of assertion that the transaction in which the security entitlement was created involved a violation of the claimant's rights.

2. Because securities trades are typically settled on a net basis by book-entry movements, it would ordinarily be impossible for anyone to trace the path of any particular security, no matter how the interest of parties who hold through intermediaries is described. Suppose, for example, that S has a 1000 share position in XYZ common stock through an account with a broker, Able & Co. S's identical twin impersonates S and directs Able to sell the securities. That same day, B places an order with Baker & Co., to buy 1000 shares of XYZ common stock. Later, S discovers the wrongful act and seeks to recover "her shares." Even if S can show that, at the stage of the trade, her sell order was matched with B's buy order, that would not suffice to show that "her shares" went to B. Settlement between Able and Baker occurs on a net basis for all trades in XYZ that day; indeed Able's net position may have been such that it received rather than delivered shares in XYZ through the settlement system.

In the unlikely event that this was the only trade in XYZ common stock executed in the market that day, one could follow the shares from S's account to B's account. The plaintiff in an action in conversion or similar legal action to enforce a property interest must show that the defendant has an item of property that belongs to the plaintiff. In this example, B's security entitlement is not the same item of property that formerly was held by S, it is a new package of rights that B acquired against Baker under Section 8-501. Principles of equitable remedies might, however, provide S with a basis for contending that if the position B received was the traceable product of the wrongful taking of S's property by S's twin, a constructive trust should be imposed on B's property in favor of S. See G. Palmer, The Law of Restitution § 2.14. Section 8-502 ensures that no such claims can be asserted against a person, such as B in this example, who acquires a security entitlement under Section 8-501 for value and without notice, regardless of what theory of law or equity is used to describe the basis of the assertion of the adverse claim.

In the above example, S would ordinarily have no reason to pursue B unless Able is insolvent and S's claim will not be satisfied in the insolvency proceedings. Because S did not give an entitlement order for the disposition of her security entitlement, Able must recredit her account for the 1000 shares of XYZ common stock. See section 8-507(b).

3. The following examples illustrate the operation of Section 8-502.

Example 1. Thief steals bearer bonds from Owner. Thief delivers the bonds to Broker for credit to Thief's securities account, thereby acquiring a security entitlement under Section 8-501(b). Under other law, Owner may have a claim to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that Thief misappropriated. Because Thief was the wrongdoer, Thief obviously had notice of Owner's adverse claim. Accordingly, Section 8-502 does not preclude Owner from asserting an adverse claim against Thief.

Example 2. Thief steals bearer bonds from Owner. Thief owes a personal debt to Creditor. Creditor has a securities account with Broker. Thief agrees to transfer the bonds to Creditor as security for or in satisfaction of his debt to Creditor. Thief does so by sending the bonds to Broker for credit to Creditor's securities account. Creditor thereby acquires a security entitlement under Section 8-501(b). Under other law, Owner may have a claim to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that Thief misappropriated. Creditor acquired the security entitlement for value, since Creditor acquired it as security for or in satisfaction of Thief's debt to Creditor. See Section 1-201(44). If Creditor did not have notice of Owner's claim, Section 8-502 precludes any action by Owner against Creditor, whether framed in constructive trust or other theory. Section 8-105 specifies what counts as notice of an adverse claim.

Example 3. Father, as trustee for Son, holds XYZ Co. shares in a securities account with Able & Co. In violation of his fiduciary duties, Father sells the XYZ Co. shares and uses the proceeds for personal purposes. Father dies, and his estate is insolvent. Assume — implausibly — that Son is able to trace the XYZ Co. shares and show that the "same shares" ended up in Buyer's securities account with Baker & Co. Section 8-502 precludes any action by Son against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

Example 4. Debtor holds XYZ Co. shares in a securities account with Able & Co. As collateral for a loan from Bank, Debtor grants Bank a security interest in the security entitlement to the XYZ Co. shares. Bank perfects by a method which leaves Debtor with the ability to dispose of the shares. See Section 9-115. In violation of the security agreement, Debtor sells the XYZ Co. shares and absconds with the proceeds. Assume — implausibly — that Bank is able to trace the XYZ Co. shares and show that the "same shares" ended up in Buyer's securities account with Baker & Co. Section 8-502 precludes any action by Bank against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

Example 5. Debtor owns controlling interests in various public companies, including Acme and Ajax. Acme owns 60% of the stock of another public company, Beta. Debtor causes the Beta stock to be pledged to Lending Bank as collateral for Ajax's debt. Acme holds the Beta stock through an account with a securities custodian, C Bank, which in turn holds through Clearing Corporation. Lending Bank is also a Clearing Corporation participant. The pledge of the Beta stock is implemented by Acme instructing C Bank to instruct Clearing Corporation to debit C Bank's account and credit Lending Bank's account. Acme and Ajax both become insolvent. The Beta stock is still valuable. Acme's liquidator asserts that the pledge of the Beta stock for Ajax's debt was wrongful as against Acme and seeks to recover the Beta stock from Lending Bank. Because the pledge was implemented by an outright transfer into Lending Bank's account at Clearing Corporation, Lending Bank acquired a security entitlement to the Beta stock under Section 8-501. Lending Bank acquired the security entitlement for value, since it acquired it as security for a debt. See Section 1-201(44). If Lending

Bank did not have notice of Acme's claim, Section 8-502 will preclude any action by Acme against Lending Bank, whether framed in constructive trust or other theory.

4. Although this section protects entitlement holders against adverse claims, it does not protect them against the risk that their securities intermediary will not itself have sufficient financial assets to satisfy the claims of all of its entitlement holders. Suppose that Customer A holds 1000 shares of XYZ Co. stock in an account with her broker, Able & Co. Able in turn holds 1000 shares of XYZ Co. through its account with Clearing Corporation, but has no other positions in XYZ Co. shares, either for other customers or for its own proprietary account. Customer B places an order with Able for the purchase of 1000 shares of XYZ Co. stock, and pays the purchase price. Able credits B's account with a 1000 share position in XYZ Co. stock, but Able does not itself buy any additional XYZ Co. shares. Able fails, having only 1000 shares to satisfy the claims of A and B. Unless other insolvency law establishes a different distributional rule, A and B would share the 1000 shares held by Able pro rata, without regard to the time that their respective entitlements were established. See Section 8-503(b). Section 8-502 protects entitlement holders, such as A and B, against adverse claimants. In this case, however, the problem that A and B face is not that someone is trying to take away their entitlements, but that the entitlements are not worth what they thought. The only role that Section 8-502 plays in this case is to preclude any assertion that A has some form of claim against B by virtue of the fact that Able's establishment of an entitlement in favor of B diluted A's rights to the limited assets held by Able.

Definitional Cross References:

"Adverse claim" Section 8-102(a)(1).
"Financial asset" Section 8-102(a)(9).
"Notice of adverse claim" Section 8-105.
"Security entitlement" Section 8-102(a)(17).
"Value" Sections 1-201(44) & 8-116.

§ 25-8-503. Property interest of entitlement holder in financial asset held by securities intermediary.

(a) To the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that financial asset held by the securities intermediary are held by the securities intermediary for the entitlement holders, are not property of the securities intermediary, and are not subject to claims of creditors of the securities intermediary, except as otherwise provided in G.S. 25-8-511.

(b) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) of this section is a pro rata property interest in all interests in that financial asset held by the securities intermediary, without regard to the time the entitlement holder acquired the security entitlement or the time the securities intermediary acquired the interest in that financial asset.

(c) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) of this section may be enforced against the securities intermediary only by exercise of the entitlement holder's rights under G.S. 25-8-505 through G.S. 25-8-508.

(d) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) of this section may be enforced against a purchaser of the financial asset or interest therein only if:

(1) Insolvency proceedings have been initiated by or against the securities intermediary;

(2) The securities intermediary does not have sufficient interests in the financial asset to satisfy the security entitle-

ments of all of its entitlement holders to that financial asset;

(3) The securities intermediary violated its obligations under G.S. 25-8-504 by transferring the financial asset or interest therein to the purchaser; and

(4) The purchaser is not protected under subsection (e) of this section.

The trustee or other liquidator, acting on behalf of all entitlement holders having security entitlements with respect to a particular financial asset, may recover the financial asset, or interest therein, from the purchaser. If the trustee or other liquidator elects not to pursue that right, an entitlement holder whose security entitlement remains unsatisfied has the right to recover its interest in the financial asset from the purchaser.

(e) An action based on the entitlement holder's property interest with respect to a particular financial asset under subsection (a) of this section, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against any purchaser of a financial asset or interest therein who gives value, obtains control, and does not act in collusion with the securities intermediary in violating the securities intermediary's obligations under G.S. 25-8-504. (1997-181, s. 1.)

OFFICIAL COMMENT

1. This section specifies the sense in which a security entitlement is an interest in the property held by the securities intermediary. It expresses the ordinary understanding that securities that a firm holds for its customers are not general assets of the firm subject to the claims of creditors. Since securities intermediaries generally do not segregate securities in such fashion that one could identify particular securities as the ones held for customers, it would not be realistic for this section to state that "customers' securities" are not subject to creditors' claims. Rather subsection (a) provides that to the extent necessary to satisfy all customer claims, all units of that security held by the firm are held for the entitlement holders, are not property of the securities intermediary, and are not subject to creditors' claims, except as otherwise provided in Section 8-511.

An entitlement holder's property interest under this section is an interest with respect to a specific issue of securities or financial assets. For example, customers of a firm who have positions in XYZ common stock have security entitlements with respect to the XYZ common stock held by the intermediary, while other customers who have positions in ABC common stock have security entitlements with respect to the ABC common stock held by the intermediary.

Subsection (b) makes clear that the property interest described in subsection (a) is an interest held in common by all entitlement holders who have entitlements to a particular security or other financial asset. Temporal factors are irrelevant. One entitlement holder cannot claim that its rights to the assets held by the intermediary are superior to the rights of another entitlement holder by virtue of having acquired those rights before, or after, the other entitlement holder. Nor does it matter whether the intermediary had sufficient assets to satisfy all entitlement holders' claims at one point, but no longer does. Rather, all entitlement holders have a pro rata interest in whatever positions in that financial asset the intermediary holds.

Although this section describes the property interest of entitlement holders in the assets held by the intermediary, it does not necessarily determine how property held by a failed intermediary will be distributed in insolvency proceedings. If the intermediary fails and its affairs are being administered in an insolvency proceeding, the applicable insolvency law governs how the various parties having claims against the firm are treated. For example, the distributional rules for stockbroker liquidation proceedings under the Bankruptcy Code and the Securities Investor Protection Act ("SIPA") provide that all customer property is distributed pro rata among all customers in proportion to the dollar value of their total positions, rather than dividing the property on an issue by issue basis. For intermediaries that are not subject to the Bankruptcy Code and SIPA, other insolvency law would determine what distributional rule is applied.

2. Although this section recognizes that the entitlement holders of a securities intermediary have a property interest in the financial assets held by the intermediary, the incidents of this property interest are established by the rules of Article 8, not by common law property concepts. The traditional Article 8 rules on certificated securities were based on the idea that a paper certificate could be regarded as a nearly complete reification of the underlying right. The rules on transfer and the consequences of wrongful transfer could then be written using the same basic concepts as the rules for physical chattels. A person's claim of ownership of a certificated security is a right to a specific identifiable physical object, and that right can be asserted against any person who ends up in possession of that physical certificate, unless cut off by the rules protecting purchasers for value without notice. Those concepts do not work for the indirect holding system. A security entitlement is not a claim to a specific identifiable thing; it is a package of rights and interests that a person has against the person's securities intermediary and the property held by the intermediary. The idea that discrete objects might be traced through the hands of different persons has no place in the Revised Article 8 rules for the indirect holding system. The fundamental principles of the indirect holding system rules are that an entitlement holder's own intermediary has the obligation to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the financial asset, and that the entitlement holder can look only to that intermediary for performance of the obligations. The entitlement holder cannot assert rights directly against other persons, such as other intermediaries through whom the intermediary holds the positions, or third parties to whom the intermediary may have wrongfully transferred interests, except in extremely unusual circumstances where the third party was itself a participant in the wrongdoing. Subsections (c) through (e) reflect these fundamental principles.

Subsection (c) provides that an entitlement holder's property interest can be enforced against the intermediary only by exercise of the entitlement holder's rights under Sections 8-505 through 8-508. These are the provisions that set out the duty of an intermediary to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the security. If the intermediary is in insolvency proceedings and can no longer perform in accordance with the ordinary Part 5 rules, the applicable insolvency law will determine how the intermediary's assets are to be distributed.

Subsections (d) and (e) specify the limited circumstances in which an entitlement holder's property interest can be asserted against a third person to whom the intermediary transferred a financial asset that was subject to the entitlement holder's claim when held by the intermediary. Subsection (d) provides that the property interest of entitlement holders cannot be asserted against any transferee except in the circumstances therein specified. So long as the intermediary is solvent, the entitlement holders must look to the intermediary to satisfy their claims. If the intermediary does not hold financial assets corresponding to the entitlement holders' claims, the intermediary has the duty to acquire them. See Section 8-504. Thus, paragraphs (1), (2), and (3) of subsection (d) specify that the only occasion in which the entitlement holders can pursue transferees is when the intermediary is unable to perform its obligation, and the transfer to the transferee was a violation of those obligations. Even in that case, a transferee who gave value and obtained control is protected by virtue of the rule in subsection (e), unless the transferee acted in collusion with the intermediary.

Subsections (d) and (e) have the effect of protecting transferees from an intermediary against adverse claims arising out of assertions by the intermediary's entitlement holders that the intermediary acted wrongfully in transferring the financial assets. These rules, however, operate in a slightly different fashion than traditional adverse claim cut-off rules. Rather than specifying that a certain class of transferee takes free from all claims, subsections (d) and (e) specify the circumstances in which this particular form of claim can be asserted against a transferee. Revised Article 8 also contains general adverse claim cut-off rules for the indirect holding system. See Sections 8-502 and 8-510. The rule of subsections (d) and (e) takes precedence over the general cut-off rules of those sections, because Section 8-503 itself defines and sets limits on the assertion of the property interest of entitlement holders. Thus, the question whether entitlement holders' property interest can be asserted as an adverse claim against a transferee from the intermediary is governed by the collusion test of Section 8-503(e), rather than by the "without notice" test of Sections 8-502 and 8-510.

3. The limitations that subsections (c) through (e) place on the ability of customers of a failed intermediary to recover securities or other financial assets from transferees are consistent with the fundamental policies of investor protection that underlie this article and other bodies of law governing the securities business. The commercial law rules for the securities holding and transfer system must be assessed from the forward-looking perspective of their impact on the vast number of transactions in which no wrongful conduct occurred or will occur, rather than from the *post hoc* perspective of what rule might be most advantageous to a particular class of persons in litigation that might arise out of the occasional case in which someone has acted wrongfully. Although one can devise hypothetical scenarios where particular customers might find it advantageous to be able to assert rights against someone other than the customers' own intermediary, commercial law rules that permitted customers to do so would impair rather than promote the interest of investors and the safe and efficient operation of the clearance and settlement system. Suppose, for example, that Intermediary A transfers securities to B, that Intermediary A acted wrongfully as against its customers in so doing, and that after the transaction Intermediary A did not have sufficient securities to satisfy its obligations to its entitlement holders. Viewed solely from the standpoint of the customers of Intermediary A, it would seem that permitting the property to be recovered from B, would be good for investors. That, however, is not the case. B may itself be an intermediary with its own customers, or may be some other institution through which individuals invest, such as a pension fund or investment company. There is no reason to think that rules permitting customers of an intermediary to trace and recover securities that their intermediary wrongfully transferred work to the advantage of investors in general. To the contrary, application of such rules would often merely shift losses from one set of investors to another. The uncertainties that would result from rules permitting such recoveries would work to the disadvantage of all participants in the securities markets.

The use of the collusion test in Section 8-503(e) furthers the interests of investors generally in the sound and efficient operation of the securities holding and settlement system. The effect of the choice of this standard is that customers of a failed intermediary must show that the transferee from whom they seek to recover was affirmatively engaged in wrongful conduct, rather than casting on the transferee any burden of showing that the transferee had no awareness of wrongful conduct by the failed intermediary. The rule of Section 8-503(e) is based on the long-standing policy that it is undesirable to impose upon purchasers of securities any duty to investigate whether their sellers may be acting wrongfully.

Rather than imposing duties to investigate, the general policy of the commercial law of the securities holding and transfer system has been to eliminate legal rules that might induce participants to conduct investigations of the authority of persons transferring securities on behalf of others for fear that they might be held liable for participating in a wrongful transfer. The rules in Part 4 of Article 8 concerning transfers by fiduciaries provide a good example. Under *Lowry v. Commercial & Farmers' Bank,* 15 F. Cas. 1040 (C.C.D. Md. 1848) (No. 8551), an issuer could be held liable for wrongful transfer if it registered transfer of securities by a fiduciary under circumstances where it had any reason to believe that the fiduciary may have been acting improperly. In one sense that seems to be advantageous for beneficiaries who might be harmed by wrongful conduct by fiduciaries. The consequence of the *Lowry* rule, however, was that in order to protect against risk of such liability, issuers developed the practice of requiring extensive documentation for fiduciary stock transfers, making such transfers cumbersome and time consuming. Accordingly, the rules in Part 4 of Article 8, and in the prior fiduciary transfer statutes, were designed to discourage transfer agents from conducting investigations into the rightfulness of transfers by fiduciaries.

The rules of Revised Article 8 implement for the indirect holding system the same policies that the rules on protected purchasers and registration of transfer adopt for the direct holding system. A securities intermediary is, by definition, a person who is holding securities on behalf of other persons. There is nothing unusual or suspicious about a transaction in which a securities intermediary sells securities that it was holding for its customers. That is exactly what securities intermediaries are in business to do. The interests of customers of securities intermediaries would not be served by a rule that required counterparties to transfers from securities intermediaries to investigate whether the intermediary was acting wrongfully against its customers. Quite the contrary, such a rule would impair the ability of securities intermediaries to perform the function that customers want.

The rules of Section 8-503(c) through (e) apply to transferees generally, including pledgees. The reasons for treating pledgees in the same fashion as other transferees are discussed in the Comments to Section 8-511. The statement in subsection (a) that an intermediary holds financial assets for customers and not as its own property does not, of course, mean that the intermediary lacks power to transfer the financial assets to others. For example, although Article 9 provides that for a security interest to attach the debtor must have "rights" in the collateral, see Section 9-203, the fact that an intermediary is holding a financial asset in a form that permits ready transfer means that it has such rights, even if the intermediary is acting wrongfully against its entitlement holders in granting the security interest. The question whether the secured party takes subject to the entitlement holder's claim in such a case is governed by Section 8-511, which is an application to secured transactions of the general principles expressed in subsections (d) and (e) of this section.

Definitional Cross References:

"Control"	Section 8-106.
"Entitlement holder"	Section 8-102(a)(7).
"Financial asset"	Section 8-102(a)(9).
"Insolvency proceedings"	Section 1-201(22).
"Purchaser"	Sections 1-201(33) & 8-116.
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).
"Value"	Sections 1-201(44) & 8-116.

§ 25-8-504. Duty of securities intermediary to maintain financial asset.

(a) A securities intermediary shall promptly obtain and thereafter maintain a financial asset in a quantity corresponding to the aggregate of all security entitlements it has established in favor of its entitlement holders with respect to that financial asset. The securities intermediary may maintain those financial assets directly or through one or more other securities intermediaries.

(b) Except to the extent otherwise agreed by its entitlement holder, a securities intermediary may not grant any security interests in a financial asset it is obligated to maintain pursuant to subsection (a) of this section.

(c) A securities intermediary satisfies the duty in subsection (a) of this section if:

(1) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset.

(d) This section does not apply to a clearing corporation that is itself the obligor of an option or similar obligation to which its entitlement holders have security entitlements. (1997-181, s. 1.)

OFFICIAL COMMENT

1. This section expresses one of the core elements of the relationships for which the Part 5 rules were designed, to wit, that a securities intermediary undertakes to hold financial assets corresponding to the security entitlements of its entitlement holders. The locution "shall promptly obtain and shall thereafter maintain" is taken from the corresponding regulation under federal securities law, 17 C.F.R. § 240.15c3-3. This section recognizes the reality that as the securities business is conducted today, it is not possible to identify particular securities as belonging to customers as distinguished from other particular securities that are the firm's own property. Securities firms typically keep all securities in fungible form, and may maintain their inventory of a particular security in various locations and forms, including physical securities held in vaults or in transit to transfer agents, and book entry positions at one or more clearing corporations. Accordingly, this section states that a securities intermediary shall maintain a quantity of financial assets corresponding to the aggregate of all security entitlements it has established. The last sentence of subsection (a) provides explicitly that the securities intermediary may hold directly or indirectly. That point is implicit in the use of the term "financial asset," inasmuch as Section 8-102(a)(9) provides that the term "financial asset" may refer either to the underlying asset or the means by which it is held, including both security certificates and security entitlements.

2. Subsection (b) states explicitly a point that is implicit in the notion that a securities intermediary must maintain financial assets corresponding to the security entitlements of its entitlement holders, to wit, that it is wrongful for a securities intermediary to grant security interests in positions that it needs to satisfy customers' claims, except as authorized by the customers. This statement does not determine the rights of a secured party to whom an securities intermediary wrongfully grants a security interest; that issue is governed by Sections 8-503 and 8-511.

Margin accounts are common examples of arrangements in which an entitlement holder authorizes the securities intermediary to grant security interests in the positions held for the entitlement holder. Securities firms commonly obtain the funds needed to provide margin loans to their customers by "rehypothecating" the customers' securities. In order to facilitate rehypothecation, agreements between margin customers and their brokers commonly authorize the broker to commingle securities of all margin customers for rehypothecation to the lender who provides the financing. Brokers commonly rehypothecate customer securities having a value somewhat greater than the amount of the loan made to the customer, since the lenders who provide the necessary financing to the broker need some cushion of protection against the risk of decline in the value of the rehypothecated securities. The extent and manner in which a firm may rehypothecate customers' securities are determined by the agreement between the intermediary and the entitlement holder and by applicable regulatory law. Current regulations under the federal securities laws require that brokers obtain the explicit consent of customers before pledging customer securities or commingling different customers' securities for pledge. Federal regulations also limit the extent to which a broker may rehypothecate customer securities to 110% of the aggregate amount of the borrowings of all customers.

3. The statement in this section that an intermediary must obtain and maintain financial assets corresponding to the aggregate of all security entitlements it has established is intended only to capture the general point that one of the key elements that distinguishes securities accounts from other relationships, such as deposit accounts, is that the intermediary undertakes to maintain a direct correspondence between the positions it holds and the claims of its customers. This section is not intended as a detailed specification of precisely how the intermediary is to perform this duty, nor whether there may be special circumstances in which an intermediary's general duty is excused. Accordingly, the general statement of the duties of a securities intermediary in this and the following sections is supplemented by two other provisions. First, each of Sections 8-504 through 8-508 contains an "agreement/due care" provision. Second, Section 8-509 sets out general qualifications on the duties stated in these sec-

tions, including the important point that compliance with corresponding regulatory provisions constitutes compliance with the Article 8 duties.

4. The "agreement/due care" provision in subsection (c) of this section is necessary to provide sufficient flexibility to accommodate the general duty stated in subsection (a) to the wide variety of circumstances that may be encountered in the modern securities holding system. For the most common forms of publicly traded securities, the modern depository-based indirect holding system has made the likelihood of an actual loss of securities remote, though correctable errors in accounting or temporary interruptions of data processing facilities may occur. Indeed, one of the reasons for the evolution of book-entry systems is to eliminate the risk of loss or destruction of physical certificates. There are, however, some forms of securities and other financial assets which must still be held in physical certificated form, with the attendant risk of loss or destruction. Risk of loss or delay may be a more significant consideration in connection with foreign securities. An American securities intermediary may well be willing to hold a foreign security in a securities account for its customer, but the intermediary may have relatively little choice of or control over foreign intermediaries through which the security must in turn be held. Accordingly, it is common for American securities intermediaries to disclaim responsibility for custodial risk of holding through foreign intermediaries.

Subsection (c)(1) provides that a securities intermediary satisfies the duty stated in subsection (a) if the intermediary acts with respect to that duty in accordance with the agreement between the intermediary and the entitlement holder. Subsection (c)(2) provides that if there is no agreement on the matter, the intermediary satisfies the subsection (a) duty if the intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset in question. This formulation does not state that the intermediary has a universally applicable statutory duty of due care. Section 1-102(3) provides that statutory duties of due care cannot be disclaimed by agreement, but the "agreement/due care" formula contemplates that there may be particular circumstances where the parties do not wish to create a specific duty of due care, for example, with respect to foreign securities. Under subsection (c)(1), compliance with the agreement constitutes satisfaction of the subsection (a) duty, whether or not the agreement provides that the intermediary will exercise due care.

In each of the sections where the "agreement/due care" formula is used, it provides that entering into an agreement and performing in accordance with that agreement is a method by which the securities intermediary may satisfy the statutory duty stated in that section. Accordingly, the general obligation of good faith performance of statutory and contract duties, see Sections 1-203 and 8-102(a)(10), would apply to such an agreement. It would not be consistent with the obligation of good faith performance for an agreement to purport to establish the usual sort of arrangement between an intermediary and entitlement holder, yet disclaim altogether one of the basic elements that define that relationship. For example, an agreement stating that an intermediary assumes no responsibilities whatsoever for the safekeeping any of the entitlement holder's securities positions would not be consistent with good faith performance of the intermediary's duty to obtain and maintain financial assets corresponding to the entitlement holder's security entitlements.

To the extent that no agreement under subsection (c)(1) has specified the details of the intermediary's performance of the subsection (a) duty, subsection (c)(2) provides that the intermediary satisfies that duty if it exercises due care in accordance with reasonable commercial standards. The duty of care includes both care in the intermediary's own operations and care in the selection of other intermediaries through whom the intermediary holds the assets in question. The statement of the obligation of due care is meant to incorporate the principles of the common law under which the specific actions or precautions necessary to meet the obligation of care are determined by such factors as the nature and value of the property, the customs and practices of the business, and the like.

5. This section necessarily states the duty of a securities intermediary to obtain and maintain financial assets only at the very general and abstract level. For the most part, these matters are specified in great detail by regulatory law. Broker-dealers registered under the federal securities laws are subject to detailed regulation concerning the safe-

guarding of customer securities. See 17 C.F.R. 240.15c3-3. Section 8-509(a) provides explicitly that if a securities intermediary complies with such regulatory law, that constitutes compliance with Section 8-503. In certain circumstances, these rules permit a firm to be in a position where it temporarily lacks a sufficient quantity of financial assets to satisfy all customer claims. For example, if another firm has failed to make a delivery to the firm in settlement of a trade, the firm is permitted a certain period of time to clear up the problem before it is obligated to obtain the necessary securities from some other source.

6. Subsection (d) is intended to recognize that there are some circumstances, where the duty to maintain a sufficient quantity of financial assets does not apply because the intermediary is not holding anything on behalf of others. For example, the Options Clearing Corporation is treated as a "securities intermediary" under this Article, although it does not itself hold options on behalf of its participants. Rather, it becomes the issuer of the options, by virtue of guaranteeing the obligations of participants in the clearing corporation who have written or purchased the options cleared through it. See Section 8-103(e). Accordingly, the general duty of an intermediary under subsection (a) does not apply, nor would other provisions of Part 5 that depend upon the existence of a requirement that the securities intermediary hold financial assets, such as Sections 8-503 and 8-508.

Definitional Cross References:

"Agreement" Section 1-201(3).

"Clearing corporation" Section 8-102(a)(5).

"Entitlement holder" Section 8-102(a)(7).

"Financial asset" Section 8-102(a)(9).

"Securities intermediary" Section 8-102(a)(14).

"Security entitlement" Section 8-102(a)(17).

§ 25-8-505. Duty of securities intermediary with respect to payments and distributions.

(a) A securities intermediary shall take action to obtain a payment or distribution made by the issuer of a financial asset. A securities intermediary satisfies the duty if:

(1) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to attempt to obtain the payment or distribution.

(b) A securities intermediary is obligated to its entitlement holder for a payment or distribution made by the issuer of a financial asset if the payment or distribution is received by the securities intermediary. (1997-181, s. 1.)

OFFICIAL COMMENT

1. One of the core elements of the securities account relationships for which the Part 5 rules were designed is that the securities intermediary passes through to the entitlement holders the economic benefit of ownership of the financial asset, such as payments and distributions made by the issuer. Subsection (a) expresses the ordinary understanding that a securities intermediary will take appropriate action to see to it that any payments or distributions made by the issuer are received. One of the main reasons that investors make use of securities intermediaries is to obtain the services of a professional in performing the record-keeping and other functions necessary to ensure that payments and other distributions are received.

2. Subsection (a) incorporates the same "agreement/due care" formula as the other provisions of part 5 dealing with the duties of a securities intermediary. See comment 4 to Section 8-504. This formulation permits the parties to specify by agreement what action, if any, the intermediary is to take with respect to the duty to obtain payments and dis-

tributions. In the absence of specification by agreement, the intermediary satisfies the duty if the intermediary exercises due care in accordance with reasonable commercial standards. The provisions of Section 8-509 also apply to the Section 8-505 duty, so that compliance with applicable regulatory requirements constitutes compliance with the Section 8-505 duty.

3. Subsection (b) provides that a securities intermediary is obligated to its entitlement holder for those payments or distributions made by the issuer that are in fact received by the intermediary. It does not deal with the details of the time and manner of payment. Moreover, as with any other monetary obligation, the obligation to pay may be subject to other rights of the obligor, by way of set-off, counterclaim, or the like. Section 8-509(c) makes this point explicit.

Definitional Cross References:

"Agreement"	Section 1-201(3).
"Entitlement holder"	Section 8-102(a)(7).
"Financial asset"	Section 8-102(a)(9).
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).

§ 25-8-506. Duty of securities intermediary to exercise rights as directed by entitlement holder.

A securities intermediary shall exercise rights with respect to a financial asset if directed to do so by an entitlement holder. A securities intermediary satisfies the duty if:

(1) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary either places the entitlement holder in a position to exercise the rights directly or exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder. (1997-181, s. 1.)

OFFICIAL COMMENT

1. Another of the core elements of the securities account relationships for which the Part 5 rules were designed is that although the intermediary may, by virtue of the structure of the indirect holding system, be the party who has the power to exercise the corporate and other rights that come from holding the security, the intermediary exercises these powers as representative of the entitlement holder rather than at its own discretion. This characteristic is one of the things that distinguishes a securities account from other arrangements where one person holds securities "on behalf of" another, such as the relationship between a mutual fund and its shareholders or a trustee and its beneficiary.

2. The fact that the intermediary exercises the rights of security holding as representative of the entitlement holder does not, of course, preclude the entitlement holder from conferring discretionary authority upon the intermediary. Arrangements are not uncommon in which investors do not wish to have their intermediaries forward proxy materials or other information. Thus, this section provides that the intermediary shall exercise corporate and other rights "if directed to do so" by the entitlement holder. Moreover, as with the other Part 5 duties, the "agreement/due care" formulation is used in stating how the intermediary is to perform this duty. This section also provides that the intermediary satisfies the duty if it places the entitlement holder in a position to exercise the rights directly. This is to take account of the fact that some of the rights attendant upon ownership of the security, such as rights to bring derivative and other litigation, are far removed from the matters that intermediaries are expected to perform.

3. This section, and the two that follow, deal with the aspects of securities holding that are related to investment decisions. For example, one of the rights of holding a particular security that would fall within the purview of this section would be the right to exercise a conver-

sion right for a convertible security. It is quite common for investors to confer discretionary authority upon another person, such as an investment adviser, with respect to these rights and other investment decisions. Because this section, and the other sections of Part 5, all specify that a securities intermediary satisfies the Part 5 duties if it acts in accordance with the entitlement holder's agreement, there is no inconsistency between the statement of duties of a securities intermediary and these common arrangements.

4. Section 8-509 also applies to the Section 8-506 duty, so that compliance with applicable regulatory requirements constitutes compliance with this duty. This is quite important in this context, since the federal securities laws establish a comprehensive system of regulation of the distribution of proxy materials and exercise of voting rights with respect to securities held through brokers and other intermediaries. By virtue of Section 8-509(a), compliance with such regulatory requirement constitutes compliance with the Section 8-506 duty.

Definitional Cross References:

"Agreement" Section 1-201(3).

"Entitlement holder" Section 8-102(a)(7).

"Financial asset" Section 8-102(a)(9).

"Securities intermediary" Section 8-102(a)(14).

"Security entitlement" Section 8-102(a)(17).

§ 25-8-507. Duty of securities intermediary to comply with entitlement order.

(a) A securities intermediary shall comply with an entitlement order if the entitlement order is originated by the appropriate person, the securities intermediary has had reasonable opportunity to assure itself that the entitlement order is genuine and authorized, and the securities intermediary has had reasonable opportunity to comply with the entitlement order. A securities intermediary satisfies the duty if:

(1) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to comply with the entitlement order.

(b) If a securities intermediary transfers a financial asset pursuant to an ineffective entitlement order, the securities intermediary shall reestablish a security entitlement in favor of the person entitled to it, and pay or credit any payments or distributions that the person did not receive as a result of the wrongful transfer. If the securities intermediary does not reestablish a security entitlement, the securities intermediary is liable to the entitlement holder for damages. (1997-181, s. 1.)

OFFICIAL COMMENT

1. Subsection (a) of this section states another aspect of duties of securities intermediaries that make up security entitlements — the securities intermediary's duty to comply with entitlement orders. One of the main reasons for holding securities through securities intermediaries is to enable rapid transfer in settlement of trades. Thus the right to have one's orders for disposition of the security entitlement honored is an inherent part of the relationship. Subsection (b) states the correlative liability of a securities intermediary for transferring a financial asset from an entitlement holder's account pursuant to an entitlement order that was not effective.

2. The duty to comply with entitlement orders is subject to several qualifications. The intermediary has a duty only with respect to an entitlement order that is in fact originated by the appropriate person. Moreover, the intermediary has a duty only if it has had reasonable opportunity to assure itself that the order is genuine and authorized, and rea-

sonable opportunity to comply with the order. The same "agreement/due care" formula is used in this section as in the other Part 5 sections on the duties of intermediaries, and the rules of Section 8-509 apply to the Section 8-507 duty.

3. Appropriate person is defined in Section 8-107. In the usual case, the appropriate person is the entitlement holder, see Section 8-107(a)(3). Entitlement holder is defined in Section 8-102(a)(7) as the person "identified in the records of a securities intermediary as the person having a security entitlement." Thus, the general rule is that an intermediary's duty with respect to entitlement orders runs only to the person with whom the intermediary has established a relationship. One of the basic principles of the indirect holding system is that securities intermediaries owe duties only to their own customers. See also Section 8-115. The only situation in which a securities intermediary has a duty to comply with entitlement orders originated by a person other than the person with whom the intermediary established a relationship is covered by Section 8-107(a)(4) and (a)(5), which provide that the term "appropriate person" includes the successor or personal representative of a decedent, or the custodian or guardian of a person who lacks capacity. If the entitlement holder is competent, another person does not fall within the defined term "appropriate person" merely by virtue of having power to act as an agent for the entitlement holder. Thus, an intermediary is not required to determine at its peril whether a person who purports to be authorized to act for an entitlement holder is in fact authorized to do so. If an entitlement holder wishes to be able to act through agents, the entitlement holder can establish appropriate arrangements in advance with the securities intermediary.

One important application of this principle is that if an entitlement holder grants a security interest in its security entitlements to a third-party lender, the intermediary owes no duties to the secured party, unless the intermediary has entered into a "control" agreement in which it agrees to act on entitlement orders originated by the secured party. See Section 8-106. Even though the security agreement or some other document may give the secured party authority to act as agent for the debtor, that would not make the secured party an "appropriate person" to whom the security intermediary owes duties. If the entitlement holder and securities intermediary have agreed to such a control arrangement, then the intermediary's action in following instructions from the secured party would satisfy the subsection (a) duty. Although an agent, such as the secured party in this example, is not an "appropriate person," an entitlement order is "effective" if originated by an authorized person. See Section 8-107(a) and (b). Moreover, Section 8-507(a) provides that the intermediary satisfies its duty if it acts in accordance with the entitlement holder's agreement.

4. Subsection (b) provides that an intermediary is liable for a wrongful transfer if the entitlement order was "ineffective." Section 8-107 specifies whether an entitlement order is effective. An "effective entitlement order" is different from an "entitlement order originated by an appropriate person." An entitlement order is effective under Section 8-107(b) if it is made by the appropriate person, or by a person who has power to act for the appropriate person under the law of agency, or if the appropriate person has ratified the entitlement order or is precluded from denying its effectiveness. Thus, although a securities intermediary does not have a duty to act on an entitlement order originated by the entitlement holder's agent, the intermediary is not liable for wrongful transfer if it does so.

Subsection (b), together with Section 8-107, has the effect of leaving to other law most of the questions of the sort dealt with by Article 4A for wire transfers of funds, such as allocation between the securities intermediary and the entitlement holder of the risk of fraudulent entitlement orders.

5. The term entitlement order does not cover all directions that a customer might give a broker concerning securities held through the broker. Article 8 is not a codification of all of the law of customers and stockbrokers. Article 8 deals with the settlement of securities trades, not the trades. The term entitlement order does not refer to instructions to a broker to make trades, that is, enter into contracts for the purchase or sale of securities. Rather, the entitlement order is the mechanism of transfer for securities held through intermediaries, just as indorsements and instructions are the mechanism for securities held directly. In the ordinary case the customer's direction to the broker to deliver the securities at settlement is implicit in the customer's instruction to the broker to sell. The distinction is, however, signifi-

cant in that this section has no application to the relationship between the customer and broker with respect to the trade itself. For example, assertions by a customer that it was damaged by a broker's failure to execute a trading order sufficiently rapidly or in the proper manner are not governed by this article.

Definitional Cross References:

"Agreement"	Section 1-201(3).
"Appropriate person"	Section 8-107.
"Effective"	Section 8-107.
"Entitlement holder"	Section 8-102(a)(7).
"Entitlement order"	Section 8-102(a)(8).
"Financial asset"	Section 8-102(a)(9).
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).

§ 25-8-508. Duty of securities intermediary to change entitlement holder's position to other form of security holding.

A securities intermediary shall act at the direction of an entitlement holder to change a security entitlement into another available form of holding for which the entitlement holder is eligible, or to cause the financial asset to be transferred to a securities account of the entitlement holder with another securities intermediary. A securities intermediary satisfies the duty if:

(1) The securities intermediary acts as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder. (1997-181, s. 1.)

OFFICIAL COMMENT

1. This section states another aspect of the duties of securities intermediaries that make up security entitlements — the obligation of the securities intermediary to change an entitlement holder's position into any other form of holding for which the entitlement holder is eligible or to transfer the entitlement holder's position to an account at another intermediary. This section does not state unconditionally that the securities intermediary is obligated to turn over a certificate to the customer or to cause the customer to be registered on the books of the issuer, because the customer may not be eligible to hold the security directly. For example, municipal bonds are now commonly issued in "book-entry only" form, in which the only entity that the issuer will register on its own books is a depository.

If security certificates in registered form are issued for the security, and individuals are eligible to have the security registered in their own name, the entitlement holder can request that the intermediary deliver or cause to be delivered to the entitlement holder a certificate registered in the name of the entitlement holder or a certificate indorsed in blank or specially indorsed to the entitlement holder. If security certificates in bearer form are issued for the security, the entitlement holder can request that the intermediary deliver or cause to be delivered a certificate in bearer form. If the security can be held by individuals directly in uncertificated form, the entitlement holder can request that the security be registered in its name. The specification of this duty does not determine the pricing terms of the agreement in which the duty arises.

2. The same "agreement/due care" formula is used in this section as in the other Part 5 sections on the duties of intermediaries. So too, the rules of Section 8-509 apply to the Section 8-508 duty.

Definitional Cross References:

"Agreement"	Section 1-201(3).
"Entitlement holder"	Section 8-102(a)(7).
"Financial asset"	Section 8-102(a)(9).
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).

§ 25-8-509. Specification of duties of securities intermediary by other statute or regulation; manner of performance of duties of securities intermediary and exercise of rights of entitlement holder.

(a) If the substance of a duty imposed upon a securities intermediary by G.S. 25-8-504 through G.S. 25-8-508 is the subject of other statute, regulation, or rule, compliance with that statute, regulation, or rule satisfies the duty.

(b) To the extent that specific standards for the performance of the duties of a securities intermediary or the exercise of the rights of an entitlement holder are not specified by other statute, regulation, or rule or by agreement between the securities intermediary and entitlement holder, the securities intermediary shall perform its duties and the entitlement holder shall exercise its rights in a commercially reasonable manner.

(c) The obligation of a securities intermediary to perform the duties imposed by G.S. 25-8-504 through G.S. 25-8-508 is subject to:

(1) Rights of the securities intermediary arising out of a security interest under a security agreement with the entitlement holder or otherwise; and

(2) Rights of the securities intermediary under other law, regulation, rule, or agreement to withhold performance of its duties as a result of unfulfilled obligations of the entitlement holder to the securities intermediary.

(d) G.S. 25-8-504 through G.S. 25-8-508 do not require a securities intermediary to take any action that is prohibited by other statute, regulation, or rule. (1997-181, s. 1.)

OFFICIAL COMMENT

This article is not a comprehensive statement of the law governing the relationship between broker-dealers or other securities intermediaries and their customers. Most of the law governing that relationship is the common law of contract and agency, supplemented or supplanted by regulatory law. This Article deals only with the most basic commercial/property law principles governing the relationship. Although Sections 8-504 through 8-508 specify certain duties of securities intermediaries to entitlement holders, the point of these sections is to identify what it means to have a security entitlement, not to specify the details of performance of these duties.

For many intermediaries, regulatory law specifies in great detail the intermediary's obligations on such matters as safekeeping of customer property, distribution of proxy materials, and the like. To avoid any conflict between the general statement of duties in this Article and the specific statement of intermediaries' obligations in such regulatory schemes, subsection (a) provides that compliance with applicable regulation constitutes compliance with the duties specified in Sections 8-504 through 8-508.

Definitional Cross References:

"Agreement"	Section 1-201(3).
"Entitlement holder"	Section 8-102(a)(7).
"Securities intermediary"	Section 8-102(a)(14).
"Security agreement"	Section 9-105(1)(l).
"Security interest"	Section 1-201(37).

§ 25-8-510. Rights of purchaser of security entitlement from entitlement holder.

(a) An action based on an adverse claim to a financial asset or security entitlement, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who purchases a security entitlement, or an interest therein, from an entitlement holder if the purchaser gives value, does not have notice of the adverse claim, and obtains control.

(b) If an adverse claim could not have been asserted against an entitlement holder under G.S. 25-8-502, the adverse claim cannot be asserted against a person who purchases a security entitlement, or an interest therein, from the entitlement holder.

(c) In a case not covered by the priority rules in Article 9, a purchaser for value of a security entitlement, or an interest therein, who obtains control has priority over a purchaser of a security entitlement, or an interest therein, who does not obtain control. Purchasers who have control rank equally, except that a securities intermediary as purchaser has priority over a conflicting purchaser who has control unless otherwise agreed by the securities intermediary. (1997-181, s. 1.)

OFFICIAL COMMENT

1. This section specifies certain rules concerning the rights of persons who purchase interests in security entitlements from entitlement holders. The rules of this section are provided to take account of cases where the purchaser's rights are derivative from the rights of another person who is and continues to be the entitlement holder.

2. Subsection (a) provides that no adverse claim can be asserted against a purchaser of an interest in a security entitlement if the purchaser gives value, obtains control, and does not have notice of the adverse claim. The primary purpose of this rule is to give adverse claim protection to persons who take security interests in security entitlements and obtain control, but do not themselves become entitlement holders.

The following examples illustrate subsection (a):

Example 1. X steals a certificated bearer bond from Owner. X delivers the certificate to Able & Co. for credit to X's securities account. Later, X borrows from Bank and grants Bank a security interest in the security entitlement. Bank obtains control under Section 8-106(d)(2) by virtue of an agreement in which Able agrees to comply with entitlement orders originated by Bank. X absconds.

Example 2. Same facts as in Example 1, except that Bank does not obtain a control agreement. Instead, Bank perfects by filing a financing statement.

In both of these examples, when X deposited the bonds X acquired a security entitlement under Section 8-501. Under other law, Owner may be able have a constructive trust imposed on the security entitlement as the traceable product of the bonds that X misappropriated. X granted a security interest in that entitlement to Bank. Bank was a purchaser of an interest in the security entitlement from X. In Example 1, although Bank was not a person who acquired a security entitlement from the intermediary, Bank did obtain control. If Bank did not have notice of Owner's claim, Section 8-510(a) precludes Owner from asserting an adverse claim against Bank. In Example 2, Bank had a perfected security interest, but did not obtain control. Accordingly, Section 8-510(a) does not preclude Owner from asserting its adverse claim against Bank.

3. Subsection (b) applies to the indirect holding system a limited version of the "shelter principle." The following example illustrates the relatively limited class of cases for which it may be needed:

Example 3. Thief steals a certificated bearer bond from Owner. Thief delivers the certificate to Able & Co. for credit to Thief's securities account. Able forwards the certificate to a clearing corporation for credit to Able's account. Later Thief instructs Able to sell the positions in the bonds. Able sells to Baker & Co., acting as broker for Buyer. The trade is settled by book-entries in the accounts of Able and Baker at the clearing corporation, and in the accounts of Thief and Buyer at Able and Baker respectively. Owner may be able to reconstruct the trade records to show that settlement occurred in such fashion that the "same bonds" that were carried in Thief's account at Able are traceable into Buyer's account at Baker. Buyer later decides to donate the bonds to Alma Mater University and executes an assignment of its rights as entitlement holder to Alma Mater.

Buyer had a position in the bonds, which Buyer held in the form of a security entitlement against Baker. Buyer then made a gift of the position to Alma Mater. Although Alma Mater is a purchaser, Section 1-201(33), it did not give value. Thus, Alma Mater is a person who purchased a security entitlement, or an interest therein, from an entitlement holder (Buyer). Buyer was protected against Owner's adverse claim by the Section 8-502 rule. Thus, by virtue of the Section 8-510(b), Owner is also precluded from asserting an adverse claim against Alma Mater.

4. Subsection (c) specifies a priority rule for cases where an entitlement holder transfers conflicting interests in the same security entitlement to different purchasers. It follows the same principle as the Article 9 priority rule for investment property, that is, control trumps non-control. Indeed, the most significant category of conflicting "purchasers" may be secured parties. Priority questions for security interests, however, are governed by the rules in Article 9. Subsection (c) applies only to cases not covered by the Article 9 rules. It is intended primarily for disputes over conflicting claims arising out of repurchase agreement transactions that are not covered by the other rules set out in Articles 8 and 9.

The following example illustrates subsection (c):

Example 4. Dealer holds securities through an account at Alpha Bank. Alpha Bank in turns holds through a clearing corporation account. Dealer transfers securities to RP1 in a "hold in custody" repo transaction. Dealer then transfers the same securities to RP2 in another repo transaction. The repo to RP2 is implemented by transferring the securities from Dealer's regular account at Alpha Bank to a special account maintained by Alpha Bank for Dealer and RP2. The agreement among Dealer, RP2, and Alpha Bank provides that Dealer can make substitutions for the securities but RP2 can direct Alpha Bank to sell any securities held in the special account. Dealer becomes insolvent. RP1 claims a prior interest in the securities transferred to RP2.

In this example Dealer remained the entitlement holder but agreed that RP2 could initiate entitlement orders to Dealer's security intermediary, Alpha Bank. If RP2 had become the entitlement holder, the adverse claim rule of Section 8-502 would apply. Even if RP2 does not become the entitlement holder, the arrangement among Dealer, Alpha Bank, and RP2 does suffice to give RP2 control. Thus, under Section 8-510(c), RP2 has priority over RP1, because RP2 is a purchaser who obtained control, and RP1 is a purchaser who did not obtain control. The same result could be reached under Section 8-510(a) which provides that RP1's earlier in time interest cannot be asserted as an adverse claim against RP2. The same result would follow under the Article 9 priority rules if the interests of RP1 and RP2 are characterized as "security interests," see Section 9-115(5)(a). The main point of the rules of Section 8-510(c) is to ensure that there will be clear rules to cover the conflicting claims of RP1 and RP2 without characterizing their interests as Article 9 security interests.

The priority rules in Article 9 for conflicting security interests also include a default rule of pro rata treatment for cases where multiple secured parties have obtained control but omitted to specify their respective rights by agreement. See Section 9-115(5)(b) and Comment 6 to Section 9-115. Because the purchaser priority rule in Section 8-510(c) is intended to track the Article 9 priority rules, it too has a pro rata rule for cases where multiple nonsecured party purchasers have obtained control but omitted to specify their respective rights by agreement.

Definitional Cross References:

"Adverse claim" Section 8-102(a)(1).

"Control" Section 8-106.

"Entitlement holder" Section 8-102(a)(7).

"Notice of adverse claim" Section 8-105.

"Purchase"	Section 1-201(32).
"Purchaser"	Sections 1-201(33) & 8-116.
"Securities intermediary"	Section 8-102(a)(14).
"Security entitlement"	Section 8-102(a)(17).
"Value"	Sections 1-201(44) & 8-116.

§ 25-8-511. Priority among security interests and entitlement holders.

(a) Except as otherwise provided in subsections (b) and (c) of this section, if a securities intermediary does not have sufficient interests in a particular financial asset to satisfy both its obligations to entitlement holders who have security entitlements to that financial asset and its obligation to a creditor of the securities intermediary who has a security interest in that financial asset, the claims of entitlement holders, other than the creditor, have priority over the claim of the creditor.

(b) A claim of a creditor of a securities intermediary who has a security interest in a financial asset held by a securities intermediary has priority over claims of the securities intermediary's entitlement holders who have security entitlements with respect to that financial asset if the creditor has control over the financial asset.

(c) If a clearing corporation does not have sufficient financial assets to satisfy both its obligations to entitlement holders who have security entitlements with respect to a financial asset and its obligation to a creditor of the clearing corporation who has a security interest in that financial asset, the claim of the creditor has priority over the claims of entitlement holders. (1997-181, s. 1.)

OFFICIAL COMMENT

1. This section sets out priority rules for circumstances in which a securities intermediary fails leaving an insufficient quantity of securities or other financial assets to satisfy the claims of its entitlement holders and the claims of creditors to whom it has granted security interests in financial assets held by it. Subsection (a) provides that entitlement holders' claims have priority except as otherwise provided in subsection (b), and subsection (b) provides that the secured creditor's claim has priority if the secured creditor obtains control, as defined in Section 8-106. The following examples illustrate the operation of these rules.

Example 1. Able & Co., a broker, borrows from Alpha Bank and grants Alpha Bank a security interest pursuant to a written agreement which identifies certain securities that are to be collateral for the loan, either specifically or by category. Able holds these securities in a clearing corporation account. Able becomes insolvent and it is discovered that Able holds insufficient securities to satisfy the claims of customers who have paid for securities that they held in accounts with Able and the collateral claims of Alpha Bank. Alpha Bank's security interest in the security entitlements that Able holds through the clearing corporation account may be perfected under the automatic perfection rule of Section 9-115(4)(c), but Alpha Bank did not obtain control under Section 8-106. Thus, under Section 8-511(a) the entitlement holders' claims have priority over Alpha Bank's claim.

Example 2. Able & Co., a broker, borrows from Beta Bank and grants Beta Bank a security interest in securities that Able holds in a clearing corporation account. Pursuant to the security agreement, the securities are debited from Alpha's account and credited to Beta's account in the clearing corporation account. Able becomes insolvent and it is discovered that Able holds insufficient securities to satisfy the claims of customers who have paid for securities that they held in accounts with Able and the collateral claims of Alpha Bank. Although the transaction between Able and Beta took the form of an outright transfer on the clearing corporation's books, as between Able and Beta, Able remains the owner and Beta has a security interest. In that respect the situation is no different than if Able had delivered bearer bonds to Beta in pledge to secure a loan. Beta's security interest is perfected, and Beta obtained control. See Sections 8-106 and 9-115. Under Section 8-511(b), Beta Bank's security interest has priority over claims of Able's customers.

The result in Example 2 is an application to this particular setting of the general principle expressed in Section 8-503, and explained in the Comments thereto, that the entitlement holders of a securities intermediary cannot assert rights against third parties to whom the intermediary has wrongfully transferred interests, except in extremely unusual circumstances where the third party was itself a participant in the transferor's wrongdoing. Under subsection (b) the claim of a secured creditor of a securities intermediary has priority over the claims of entitlement holders if the secured creditor has obtained control. If, however, the secured creditor acted in collusion with the intermediary in violating the intermediary's obligation to its entitlement holders, then under Section 8-503(e), the entitlement holders, through their representative in insolvency proceedings, could recover the interest from the secured creditor, that is, set aside the security interest.

2. The risk that investors who hold through an intermediary will suffer a loss as a result of a wrongful pledge by the intermediary is no different than the risk that the intermediary might fail and not have the securities that it was supposed to be holding on behalf of its customers, either because the securities were never acquired by the intermediary or because the intermediary wrongfully sold securities that should have been kept to satisfy customers' claims. Investors are protected against that risk by the regulatory regimes under which securities intermediaries operate. Intermediaries are required to maintain custody, through clearing corporation accounts or in other approved locations, of their customers' securities and are prohibited from using customers' securities in their own business activities. Securities firms who are carrying both customer and proprietary positions are not permitted to grant blanket liens to lenders covering all securities which they hold, for their own account or for their customers. Rather, securities firms designate specifically which positions they are pledging. Under SEC Rules 8c-1 and 15c2-1, customers' securities can be pledged only to fund loans to customers, and only with the consent of the customers. Customers' securities cannot be pledged for loans for the firm's proprietary business; only proprietary positions can be pledged for proprietary loans. SEC Rule 15c3-3 implements these prohibitions in a fashion tailored to modern securities firm accounting systems by requiring brokers to maintain a sufficient inventory of securities, free from any liens, to satisfy the claims of all of their customers for fully paid and excess margin securities. Revised Article 8 mirrors that requirement, specifying in Section 8-504 that a securities intermediary must maintain a sufficient quantity of investment property to satisfy all security entitlements, and may not grant security interests in the positions it is required to hold for customers, except as authorized by the customers.

If a failed brokerage has violated the customer protection regulations and does not have sufficient securities to satisfy customers' claims, its customers are protected against loss from a shortfall by the federal Securities Investor Protection Act ("SIPA"). Securities firms required to register as brokers or dealers are also required to become members of the Securities Investor Protection Corporation ("SIPC"), which provides their customers with protection somewhat similar to that provided by FDIC and other deposit insurance programs for bank depositors. When a member firm fails, SIPC is authorized to initiate a liquidation proceeding under the provisions of SIPA. If the assets of the securities firm are insufficient to satisfy all customer claims, SIPA makes contributions to the estate from a fund financed by assessments on its members to protect customers against losses up to $500,000 for cash and securities held at member firms.

Article 8 is premised on the view that the important policy of protecting investors against the risk of wrongful conduct by their intermediaries is sufficiently treated by other law.

3. Subsection (c) sets out a special rule for secured financing provided to enable clearing corporations to complete settlement. The reasons that secured financing arrangements are needed in such circumstances are explained in Comment 7 to Section 9-115. In order to permit clearing corporations to establish liquidity facilities where necessary to ensure completion of settlement, subsec-

tion (c) provides a priority for secured lenders to such clearing corporations. Subsection (c) does not turn on control because the clearing corporation may be the top tier securities intermediary for the securities pledged, so that there may be no practicable method for conferring control on the lender.

Definitional Cross References:

"Clearing corporation" Section 8-102(a)(5).

"Control" Section 8-106.

"Entitlement holder" Section 8-102(a)(7).

"Financial asset" Section 8-102(a)(9).

"Securities intermediary" Section 8-102(a)(14).

"Security entitlement" Section 8-102(a)(17).

"Security interest" Section 1-201(37).

"Value" Sections 1-201(44) & 8-116.

TABLES OF COMPARABLE SECTIONS FOR CHAPTER 25, REVISED ARTICLE 8

Former to Present

Editor's Note. — The following table shows G.S. sections from former Chapter 25, Article 8, and their comparable, new revised Chapter 25, Article 8 numbers. Where there is no comparable new number, the term "Omitted" has been inserted.

Former Section	Present Section
25-8-101	25-8-101
25-8-102(1)(a)	25-8-102(a)(4) and (15)
25-8-102(1)(b)	25-8-102(a)(15) and (18)
25-8-102(1)(c)	25-8-102(a)(15)
25-8-102(1)(d)	25-8-102(a)(13)
25-8-102(1)(e)	25-8-102(a)(2)
25-8-102(2)	25-8-202(b)(1)
25-8-102(3)	25-8-102(a)(5)
25-8-1-2(4)	Omitted
25-8-102(5)	25-8-102(b)
25-8-102(6)	25-8-102(c)
25-8-103	25-8-209
25-8-104	25-8-210
25-8-105(1)	Omitted
25-8-105(2)	Omitted
25-8-105(3)	25-8-114
25-8-106	25-8-110
25-8-107	Omitted
25-8-108	Omitted
25-8-201	25-8-201
25-8-202	25-8-202
25-8-203	25-8-203
25-8-204	25-8-204
25-8-205	25-8-205
25-8-206	25-8-206
25-8-207	25-8-207
25-8-208	25-8-208
25-8-301	25-8-302(a) and (b)
25-8-302(1)	25-8-303(a)
25-8-302(2)	25-8-102(a)(1)
25-8-302(3)	25-8-303(b)
25-8-302(4)	25-8-302(c)
25-8-303	25-8-102(a)(3)
25-8-304(1)	25-8-105(d)
25-8-304(2)	Omitted
25-8-304(3)	25-8-105(b)
25-8-305	25-8-105(c)
25-8-306(1)	25-8-108(f)
25-8-306(2)	25-8-108(a)
25-8-306(3)	25-8-108(g)
25-8-306(4)	25-8-108(h)
25-8-306(5)	25-8-108(e)
25-8-306(6)	25-8-306(h)
25-8-306(7)	25-8-108(b), 25-8-306(h)
25-8-306(8)	Omitted
25-8-306(9)	25-8-108(c)
25-8-306(10)	25-8-108(i)
25-8-307	25-8-304(d)
25-8-308(1)	25-8-102(a)(11), 25-8-107
25-8-308(2)	25-8-304(a)
25-8-308(3)	25-8-304(b)
25-8-308(4)	25-8-102(a)(12)
25-8-308(5)	25-8-107, 25-8-305(a)
25-8-308(6)	25-8-107
25-8-308(7)	25-8-107
25-8-308(8)	25-8-107
25-8-308(9)	25-8-304(f), 25-8-305(b)
25-8-308(10)	25-8-107
25-8-308(11)	25-8-107
25-8-309	25-8-304(c)
25-8-310	25-8-304(e)
25-8-311(a)	Omitted, see 25-8-106(b)(2), 25-8-301(b)(1), 25-8-303
25-8-311(b)	25-8-404
25-8-312	25-8-306
25-8-313(1)(a)	Omitted, see 25-8-301(a)(1) and (2)
25-8-313(1)(b)	Omitted, see 25-8-301(b)(1) and (2)
25-8-313(1)(c)	Omitted, see 25-8-301(a)(3)
25-8-313(1)(d)	Omitted, see 25-8-501(b)
25-8-313(1)(e)	Omitted, see 25-8-301(a)(2)
25-8-313(1)(f)	Omitted, see 25-8-301(b)(2)
25-8-313(1)(g)	Omitted, see 25-8-501(b), 25-8-111
25-8-313(1)(h)-(j)	Omitted, see 25-9-115, 25-9-203
25-8-313(2)	Omitted, see 25-8-503
25-8-313(3)	Omitted
25-8-313(4)	25-8-102(a)(14)
25-8-314	Omitted
25-8-315	Omitted
25-8-316	25-8-307
25-8-317	25-8-112
25-8-318	25-8-115

Former Section	Present Section	Former Section	Present Section
25-8-319	Omitted, see 25-8-113	25-8-404	25-8-404
25-8-320	Omitted	25-8-405(1)	25-8-406
25-8-321	Omitted, see 25-9-115, 25-9-203	25-8-405(2)	25-8-405(a)
25-8-401	25-8-401	25-8-405(3)	25-8-405(b)
25-8-402	25-8-402	25-8-406	25-8-407
25-8-403	25-8-403	25-8-407	Omitted
		25-8-408	Omitted

ARTICLE 9.

Secured Transactions; Sales of Accounts and Chattel Paper.

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PART 1.

SHORT TITLE, APPLICABILITY AND DEFINITIONS.

§ 25-9-103. Perfection of security interests in multiple-state transactions.

(1) Documents, Instruments and Ordinary Goods. —

(a) This subsection applies to documents and instruments and to goods other than those covered by a certificate of title described in subsection (2), mobile goods described in subsection (3), and minerals described in subsection (5).

(b) Except as otherwise provided in this subsection, perfection and the effect of perfection or nonperfection of a security interest in collateral are governed by the law of the jurisdiction where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected.

(c) If the parties to a transaction creating a purchase money security interest in goods in one jurisdiction understand at the time that the security interest attaches that the goods will be kept in another jurisdiction, then the law of the other jurisdiction governs the perfection and the effect of perfection or nonperfection of the security interest from the time it attaches until 30 days after the debtor receives possession of the goods and thereafter if the goods are taken to the other jurisdiction before the end of the 30-day period.

(d) When collateral is brought into and kept in this State while subject to a security interest perfected under the law of the jurisdiction from which the collateral was removed, the security interest remains perfected, but if action is required by part 3 of this article to perfect the security interest,

(i) if the action is not taken before the expiration of the period of perfection in the other jurisdiction or the end of four months after the collateral is brought into this State, whichever period first expires, the security interest becomes unperfected at the end of that period and is thereafter deemed to have been unperfected as against a person who became a purchaser after removal;

(ii) if the action is taken before the expiration of the period specified in subparagraph (i), the security interest continues perfected thereafter;

(iii) for the purpose of priority over a buyer of consumer goods (subsection (2) of G.S. 25-9-307), the period of the effectiveness of a filing in the jurisdiction from which the collateral is removed is governed by the rules with respect to perfection in subparagraphs (i) and (ii).

(2) Certificate of Title. —

(a) This subsection applies to goods covered by a certificate of title issued under a statute of this State or of another jurisdiction under the law of which indication of a security interest on the certificate is required as a condition of perfection.

(b) Except as otherwise provided in this subsection, perfection and the effect of perfection or nonperfection of the security interest are governed by the law (including the conflict of laws rules) of the jurisdiction issuing the certificate until four months after the goods are removed from that jurisdiction and thereafter until the goods are registered in another jurisdiction, but in any event not beyond surrender of the certificate. After the expiration of that period, the goods are not covered by the certificate of title within the meaning of this section.

(c) Except with respect to the rights of a buyer described in the next paragraph, a security interest, perfected in another jurisdiction otherwise than by notation on a certificate of title, in goods brought into this State and thereafter covered by a certificate of title issued by this State is subject to the rules stated in paragraph (d) of subsection (1).

(d) If goods are brought into this State while a security interest therein is perfected in any manner under the law of the jurisdiction from which the goods are removed and a certificate of title is issued by this State and the certificate does not show that the goods are subject to the security interest or that they may be subject to security interests not shown on the certificate, the security interest is subordinate to the rights of a buyer of the goods who is not in the business of selling goods of that kind to the extent that he gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest.

(3) Accounts, General Intangibles and Mobile Goods. —

(a) This subsection applies to accounts (other than an account described in subsection (5) on minerals) and general intangibles (other than uncertificated securities) and to goods which are mobile and which are of a type normally used in more than one jurisdiction, such as motor vehicles, trailers, rolling stock, airplanes, shipping containers, road-building and construction machinery and commercial harvesting machinery and the like, if the goods are equipment or are inventory leased or held for lease by the debtor to others, and are not covered by a certificate of title described in subsection (2).

(b) The law (including the conflict of laws rules) of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection or nonperfection of the security interest.

(c) If, however, the debtor is located in a jurisdiction which is not a part of the United States, and which does not provide for perfection of the security interest by filing or recording in that jurisdiction, the law of the jurisdiction in the United States in which the debtor has its major executive office in the United States governs the perfection and the effect of perfection or nonperfection of the security interest through filing. In the alternative, if the debtor is located in a jurisdiction which is not a part of the United States or Canada and the collateral is accounts or general intangibles for money due or to become due, the security interest may be perfected by notification to the account debtor. As used in this paragraph, "United States" includes its territories and possessions and the Commonwealth of Puerto Rico.

(d) A debtor shall be deemed located at his place of business if he has one, at his chief executive office if he has more than one place of business, otherwise at his residence. If, however, the debtor is a foreign air carrier under the Federal Aviation Act of 1958, as amended, it shall be deemed located at the designated office of the agent upon whom service of process may be made on behalf of the foreign air carrier.

(e) A security interest perfected under the law of the jurisdiction of the location of the debtor is perfected until the expiration of four months after a change of the debtor's location to another jurisdiction, or until perfection would have ceased by the law of the first jurisdiction, whichever period first expires. Unless perfected in the new jurisdiction before the end of that period, it becomes unperfected thereafter and is deemed to have been unperfected as against a person who became a purchaser after the change.

(4) Chattel Paper. — The rules stated for goods in subsection (1) apply to a possessory security interest in chattel paper. The rules stated for accounts in subsection (3) apply to a nonpossessory security interest in chattel paper, but the security interest may not be perfected by notification to the account debtor.

(5) Minerals. — Perfection and the effect of perfection or nonperfection of a security interest which is created by a debtor who has an interest in minerals or the like (including oil and gas) before extraction and which attaches thereto as extracted, or which attaches to an account resulting from the sale thereof at the wellhead or minehead, are governed by the law (including the conflict of laws

rules) of the jurisdiction wherein the wellhead or minehead is located.

(6) Investment property. —

(a) This subsection applies to investment property.

(b) Except as otherwise provided in paragraph (f) of this subsection, during the time that a security certificate is located in a jurisdiction, perfection of a security interest, the effect of perfection or nonperfection, and the priority of a security interest in the certificated security represented thereby are governed by the local law of that jurisdiction.

(c) Except as otherwise provided in paragraph (f) of this subsection, perfection of a security interest, the effect of perfection or nonperfection, and the priority of a security interest in an uncertificated security are governed by the local law of the issuer's jurisdiction as specified in G.S. 25-8-110(d).

(d) Except as otherwise provided in paragraph (f) of this subsection, perfection of a security interest, the effect of perfection or nonperfection, and the priority of a security interest in a security entitlement or securities account are governed by the local law of the securities intermediary's jurisdiction as specified in G.S. 25-8-110(e).

(e) Except as otherwise provided in paragraph (f) of this subsection, perfection of a security interest, the effect of perfection or nonperfection, and the priority of a security interest in a commodity contract or commodity account are governed by the local law of the commodity intermediary's jurisdiction. The following rules determine a "commodity intermediary's jurisdiction" for purposes of this paragraph:

(i) If an agreement between the commodity intermediary and commodity customer specifies that it is governed by the law of a particular jurisdiction, that jurisdiction is the commodity intermediary jurisdiction.

(ii) If an agreement between the commodity intermediary and commodity customer does not specify the governing law as provided in subparagraph (i), but expressly specifies that the commodity account is maintained at an office in a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(iii) If an agreement between the commodity intermediary and commodity customer does not specify a jurisdiction as provided in subparagraphs (i) or (ii), the commodity intermediary's jurisdiction is the jurisdiction in which is located the office identified in an account statement as the office serving the commodity customer's account.

(iv) If an agreement between the commodity intermediary and commodity customer does not specify a jurisdiction as provided in subparagraphs (i) or (ii) and an account statement does not identify an office serving the commodity customer's account as provided in subparagraph (iii), the commodity intermediary's jurisdiction is the jurisdiction in which is located the chief executive office of the commodity intermediary.

(f) Perfection of a security interest by filing, automatic perfection of a security interest in investment property granted by a broker or securities intermediary, and automatic perfection of a security interest in a commodity contract or commodity account granted by a commodity intermediary are governed by the local law of the jurisdiction in which the debtor is located. (1945, c. 196, s. 2; 1957, c. 564; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(e), (f); 1997-181, s. 2.)

OFFICIAL COMMENT

Prior Uniform Statutory Provisions: Paragraph 1(d): Section 14, Uniform Conditional Sales Act.

Purposes:

1. The general rules on choice of law between the original parties in Section 1-105 apply to this Article. However, when conflicting claims to collateral arise, the question depends on *perfection* of security interests, and thus on the effect of perfection or non-perfection. These problems are dealt with in this section. The general rule (paragraph (1)(b)) is that these questions are governed by the law of the jurisdiction where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected. This event will frequently be the filing. If the last event is not filing and perfection is through filing, the filing required is in the jurisdiction where the collateral is when the last event occurs; prior filing in another jurisdiction is not effective and is not saved by the four-month rule discussed below, which applies only when the security interest was *perfected* in the jurisdiction from which the collateral was removed. If the security interest was perfected in one jurisdiction and then removed to another jurisdiction, maintenance of perfection in the latter jurisdiction or failure to do so is the "last event" to which the basic rule refers.

There are, however, exceptions to this basic rule:

2. If the parties to a transaction creating a purchase money security interest in goods understand when the security interest attaches that the collateral will be kept in another jurisdiction, the law of that jurisdiction governs perfection and the effect of perfection or non-perfection until 30 days after the debtor receives possession of the goods (paragraph (1)(c)). A filing in that jurisdiction perfects the security interest even before the goods are removed. The 30-day period is not a period of grace during which filing is unnecessary or has retroactive effect, but merely states the period during which the other jurisdiction is the place of filing. The effect of late filing is governed by other provisions, such as Sections 9-301 and 9-312.

3. If the goods reach that jurisdiction within the 30 days, the effectiveness of the filing in that jurisdiction continues without interruption. If the collateral is not kept in that jurisdiction before the end of the 30-day period, paragraph (1)(c) ceases to be applicable and thereafter the law of the jurisdiction where the collateral is controls perfection. A failure of the collateral to reach the intended destination jurisdiction before the expiration of the 30-day period because of a conflicting claim or otherwise may cause disappointment of expectations that the law of the destination jurisdiction will govern continuously, and caution may dictate filing both in that jurisdiction and in the jurisdiction where the security interest attaches.

This section uses the concepts that goods are "kept" in a state or "brought" into a state, and related terms. These concepts imply a stopping place of a permanent nature in the state, not merely transit or storage intended to be transitory.

4. (a) Where the collateral is an automobile or other goods covered by a certificate of title issued by any state and the security interest is perfected by notation on the certificate of title, perfection is controlled by the certificate of title rather than by the law of the state wherein the security interest attached (subsection (2)).

(b) It has long been hoped that "exclusive certificate of title laws" would provide a sure means of controlling property interests in goods like automobiles, which because of their nature cannot readily be controlled by local or statewide filing alone. In theory the certificate of title should control the property interests in the vehicle wherever the vehicle may be. However, two circumstances operate to prevent the perfect operation of the certificate of title device:

First, some states have never adopted certificate of title laws. This results in a problem in the issuance of a certificate of title when the vehicle moves from a non-certificate to a certificate state, because the certificate-issuing officer is in no position to conduct a complete search to ascertain the condition of the title in a state of origin which requires no filing or in which filing could be in any one or more of several localities. Also, it seems that when a vehicle moves from a certificate to a non-certificate state, the officers issuing a new registration for the vehicle are not always meticulous to notify secured parties shown on the certificate to give them a chance to perfect their security interests in the non-certificate state when a new registration is issued. Moreover, some vehicles like mobile homes are not always registered and title certificates are not always issued even in a state which may have certificate laws applicable thereto, because the certificate laws may apply only if the mobile homes use the highways. Registration plates of a mobile home having a certificate could be removed and there would be nothing visible to show that a certificate had ever been issued for it.

Second, various fraudulent devices based on allegations of loss of the certificate of title enable a dishonest person to obtain both an original and a duplicate of title; to have a security interest shown on only one thereof; and then to effect a transfer into a new state on the basis of the clean certificate, no matter how diligent the officers in the second state may be.

Given these practical problems, the choice of applicable rules of law after interstate removals of vehicles subject to certificate of title laws is most difficult. This Article provides the rules set forth below.

(c) The security interest perfected by notation on a certificate of title will be recognized without limit as to time; but, of course, perfection by this method ceases if the certificate of title is surrendered (paragraph (2)(b)). Since the secured party ordinarily holds the certificate, surrender thereof could not occur without his action in the matter in some respect. If the vehicle is reregistered in another jurisdiction while the secured party still holds the certificate, a danger of deception to third parties arises. The section provides that the certificate ceases to control after 4 months following removal if reregistration has occurred, but during the 4 months the secured party has the same protection for cases of interstate removal as is set forth in paragraph (1)(d) of the section and Comment 7, subject to additional limitation if the reregistration also involves a new "clean" certificate of title in the removal jurisdiction and a non-professional buyer buys while that new certificate is outstanding. See paragraph (2)(d) and Comment 4(e).

(d) If a vehicle not described in the preceding paragraph (i.e., not covered by a certificate of title) is removed to a certificate state and a certificate is issued therefor, the holder of a security interest has the same 4-month protection, subject to the provision discussed in the next paragraph of Comment.

(e) Where "this state" issues a certificate of title on collateral that has come from another state subject to a security interest perfected in any manner, problems will arise if this state, from whatever cause, fails to show on its certificate the security interest perfected in the other jurisdiction. This state will have every reason, nevertheless, to make its certificate of title reliable to the type of person who most needs to rely on it. Paragraph (2)(d) of the section therefore provides that the security interest perfected in the other jurisdiction is subordinate to the rights of a limited class of persons buying the goods while there is a clean certificate of title issued by this state, without knowledge of the security interest perfected in the other jurisdiction. The limited class are buyers who are nonprofessionals, i.e., not dealers and not secured parties, because these are ordinarily professionals. The protective rule mentioned does not apply if this state adopts a device used under some certificate of title laws, namely, stating on the certificate of title that the vehicle may be subject to security interests not shown on the certificate, where the collateral came from a noncertificate state.

In any event the security interest perfected out of state becomes unperfected unless reperfected in this state under the usual 4-month rule (paragraph (2)(d) of the section). States which place a cautionary statement on a certificate of title coming from a non-certificate state make provision to reissue the certificate without the caution after four months.

One difficulty is that no state's certificate of title law makes any provision by which a foreign security interest may be reperfected in that state, without the cooperation of the owner or other person holding the certificate in temporarily surrendering the certificate. But that cooperation is not likely to be forthcoming from an owner who wrongfully procured the issuance of a new certificate not showing the out-of-state security interest, or from a local secured party finding himself in a priority contest with the out-of-state secured party. The only solution for the out-of-state secured party under present certificate of title laws seems to be reperfect by possession, i.e., by repossessing the goods.

5. The general rules of the section based on location of the collateral could not be applied to certain types of intangible collateral which have no location in any realistic sense, or to certain movable chattels which have no permanent location.

(a) For accounts and general intangibles there is no indispensable or symbolic document which represents the underlying claim, whose endorsement or delivery is the one effectual means of transfer. There is a considerable body of case law dealing with the situs of choses in action such as these. This case law is in the highest degree confused, contradictory and uncertain: it affords no base on which to build a statutory rule.

An account arises typically out of a sale; the contract of sale may be executed in State A, the goods shipped from a warehouse in State B to buyer (account debtor) in State C. The account may then be assigned to an assignee in State D. The seller-assignor may keep his principal records in State E. Under the non-notification system of accounts financing, the seller-assignor, despite the assignment, bills and collects from the account debtor; under notification financing the account debtor makes payment to the assignee, but the bills may be prepared and sent out by either assignor or assignee. The contacts of the transaction are with many jurisdictions: to which one is it appropriate to look for the governing law? Even more complicated situations may be anticipated when the collateral consists of novel or uncommon types of personal property, which fall within the definition of general intangibles.

If we bear in mind that our principal question is where certain financing statements shall be filed, two things become clear. *First:* since the purpose of filing is to allow subsequent creditors of the *debtor-assignor* to determine the true status of his affairs, the place chosen must be one which such creditors would normally associate with the assignor; thus the place of business of the assignee and the places of business or residences of the various account debtors must be rejected in ordinary situations. *Second:* the place chosen must be one which can be determined with the least possible risk of error. The place chosen by subsection (3) is the debtor's location, which is ordinarily the location of its chief executive office. This concept is discussed below.

(b) Another class of collateral for which a special rule is stated in subsection (3) is mobile goods of types which are normally moved for use from one jurisdiction to another. Such goods are generally classified as equipment; sometimes they may be classified as inventory, for example, goods leased by a professional lessor. Subsection (3) provides that a security interest in such equipment or inventory is subject to this Article when the debtor's location, i. e., ordinarily its chief executive office, is in this state.

While automobiles are obviously mobile goods, they will in most cases be covered by subsection (2) of this section and therefore excluded from subsection (3) by paragraph (a) thereof. If an automobile is not covered by a certificate of title and is classified as equipment or as inventory under lease, it will be subject to subsection (3). Automobiles and other mobile goods which are classified as consumer goods are not subject to subsection (3).

The rule of subsection (3) applies to goods of a type "normally used" in more than one jurisdiction; there is no requirement that particular goods be in fact used out of state. Thus, if an enterprise whose chief executive office is in State X keeps in State Y goods of the type covered by subsection (3), the rule of subsection (3) requires filing in State X even though the goods never leave State Y.

(c) "Chief executive office" does not mean the place of incorporation; it means the place from which in fact the debtor manages the main part of his business operations. This is the place where persons dealing with the debtor would normally look for credit information, and is the appropriate place for filing. The term "chief executive office" is not defined in this Section or elsewhere in this Act. Doubt may arise as to which is the "chief executive office" of a multistate enterprise, but it would be rare that there could be more than two possibilities. A secured party in such a case may easily protect himself at no great additional burden by filing in each possible place. The subsection states a rule which will be simple to apply in most cases, and which makes it possible to dispense with much burdensome and useless filing.

(d) If the location of the debtor is moved after a security interest has been perfected in another jurisdiction, the secured party has four months within which to refile, unless the perfection in the original jurisdiction would have expired earlier (paragraph (3)(e)).

(e) Under subsection (3) each state other than that of the debtor's location in effect disclaims jurisdiction over certain accounts and general intangibles which, by common law rules, might be held to be within its jurisdiction; in the same way there is a disclaimer of jurisdiction over mobile chattels, even though they may be physically located within the state much of the time. If the jurisdiction whose law controls under this rule is a United States jurisdiction or has enacted legislation permitting perfection of the security interest by filing or recording in that jurisdiction, the law of that jurisdiction will be recognized in the disclaiming jurisdiction as perfecting the security interest. The jurisdiction of the debtor's location may not, however, have such legislation. For example, mobile equipment is used in New York; the debtor's chief place of business is in a Canadian jurisdiction which will not permit or recognize filing as to property not physically located therein. Paragraph (3)(c) solves this difficulty by permitting perfection through filing in the jurisdiction in the United States in which the debtor has its major executive office in the United States. Where the debtor is not located in the United States or Canada and the collateral is accounts or general intangibles for money due or to become due, the secured party may alternatively perfect by notification to account debtors.

(f) A sentence in paragraph (3)(d) provides a special rule for security interests in airplanes owned by a foreign air carrier. Without that sentence subsection (3) might refer such a case to the law of a foreign nation whose law is difficult or impossible to ascertain. The sentence clears up such doubts by treating as the location of the carrier the office designated for service of process in the United States under the Federal Aviation Act of 1958. To the extent that it is applicable, the Convention on the International Recognition of Rights in Aircraft (Geneva Convention) supersedes state legislation on this subject, as set forth in Section 9-302(3), but some nations are not parties to that Convention.

6. Subsection (4) deals with chattel paper, a semi-intangible security interest which may be perfected either by possession or by filing (Sections 9-304(1), 9-305). As to possessory security, subsection (4) provides that chattel paper shall be subject to the same rule as goods in subsection (1). As to non-possessory security, subsection (4) provides that it shall be subject to the same rule as the intangibles under subsection (3), except that notification to the account debtor is ruled out as an optional means of perfection under paragraph (3)(c). The reason for this is that a different alternative, possession, is available for chattel paper.

7. In addition to the foregoing rules defining which jurisdiction governs perfection of a security interest in the first instance, "this state" (i.e., a destination state after removal) adds its own rules requiring reperfection following removal of collateral other than that described in subsections (2), (3), and (5). "This state" will for four months recognize perfection under the law of the jurisdiction from which the collateral came, unless the remaining period of effectiveness of the perfection in that jurisdiction was less than four months (paragraph (1)(d)). After the four month period or the remaining period of effectiveness, whichever is shorter, the secured party must comply with perfection requirements in this state. This rule differs from the former rule of Section 14 of the Uniform Conditional Sales Act. Under that section a conditional seller was required to file within 10 days after he "received notice" that the goods had been removed into this state. Apparently, under the Uniform Conditional Sales Act, if the seller never "received notice" his interest continued or became perfected in this state without filing. Paragraph (1)(d) proceeds on the theory that not only the secured party whose collateral has been removed but also creditors of and purchasers from the debtor "in this state" should be considered.

The four-month period is long enough for a secured party to discover in most cases that the collateral has been removed and refile in this state; thereafter, if he has not done so, his interest, although originally perfected in the jurisdiction from which the collateral was removed, is subject to defeat here by purchasers of the collateral. Compare the situation arising under Section 9-403(2) when a filing lapses.

It should be noted that a "purchaser"

includes a secured party. Section 1-201(32) and (33). The rights of a purchaser with a security interest against an unperfected security interest are governed by Section 9-312.

In case of delay beyond the four-month period, there is no "relation back"; and this is also true where the security interest is perfected for the first time in this state.

If the removal occurs within a short period, like two weeks, before the lapse of the filing in the original state, the secured party has only that period, not the full four months, to reperfect in "this state". But ordinarily he would have filed a continuation statement in the original jurisdiction; and he may do so to avoid lapse and allow himself the full four months if he is searching for the collateral and needs more time.

Paragraph (1)(d) does not apply to the case of goods removed from one filing district to another within this state (see subsection (3) of Section 9-401), but only to property brought into this state from another jurisdiction.

8. Subsection (5) deals with problems relating to the financing of minerals (including oil and gas) as these products come from the ground. In some cases rights in oil and gas in the ground have been split into a large variety of interests. As the oil or gas issues from the ground, it may be encumbered by the group of persons having interests therein. Or the product may be sold at minehead or wellhead and the resulting accounts assigned. The question arises as to the place of filing. The usual rule of this section in subsection (2) would make the place to search for encumbrances on the accounts the locations of the respective assignors; but the assignors might be a number of individuals located throughout the country. To avoid the difficult problems of search thus created, subsection (5) provides that the place for filing with respect to security interests in the minerals as they issue from the ground at minehead or wellhead or in the accounts arising out of the sale of the minerals at minehead or wellhead shall be in the state where the minehead or wellhead is located. Section 9-401 similarly provides that the place to file within the state is in the real property records in the county where the minehead or wellhead is located. These rules conform to pre-Code practice and to practice which seems to have continued in the early Code period before express provision was made for these situations.

The term "at wellhead" is intended to encompass arrangements based on sale of the product as soon as it issues from the ground and is measured, without technical distinctions as to whether title passes at the "Christmas tree" or the far side of a gathering tank or at some other point. The term "at minehead" is a comparable concept.

9. Subsection (6) of Section 9-103 specifies choice of law rules for perfection of security interests in investment property. Paragraph (b) covers security interests in certificated securities. Paragraph (c) covers security interests in uncertificated securities. Paragraph (d) covers security interests in security entitlements and securities accounts. Paragraph (e) covers security interests in commodity contracts and commodity accounts. The approach of each of these paragraphs is essentially the same. They identify the jurisdiction's law that governs questions of perfection and priority on the basis of the same principles that are used in Article 8 to determine other questions concerning that form of investment property. Thus, for certificated securities, the law of the jurisdiction where the certificate is located governs. Cf. Section 8-110(c). For uncertificated securities, the law of the issuer's jurisdiction governs. Cf. Section 8-110(a). For security entitlements and securities accounts, the law of the securities intermediary's jurisdiction governs. Cf. Section 8-110(b). For commodity contracts and commodity accounts, the law of the commodity intermediary's jurisdiction governs. Since commodity contracts and commodity accounts are not governed by Article 8, paragraph (e) contains rules that specify the commodity intermediary's jurisdiction. These are analogous to the rules in Section 8-110(e) specifying a securities intermediary's jurisdiction.

Under this subsection, if litigation about perfection or priority arises in this State, the relevant choice of law rule of paragraphs (b) through (e) may point to the law of this State or to the law of another State. If the litigation were in a tribunal of a jurisdiction that has not enacted this section, it would follow its own choice of law rules. The choice of law rules prescribed here by statute conform to generally accepted principles of choice of law. The simplicity and clarity in the choice of law rules, coupled with the explicit recognition that the parties to some securities transactions may agree on a governing law, are intended to assure that there will be one clear choice of law regardless of forum.

Paragraph (f) adapts the general choice of law principles of this subsection to cases where a secured party claims perfection on the basis of filing, or by virtue of the automatic perfection rules in Section 9-115(4)(c) and (d). In such a case, the law of the debtor's jurisdiction determines whether the requirements for that form of perfection have been satisfied. The rules in Section 9-103(3) on the debtor's location and effect of change of location apply to cases governed by paragraph (f)*. The main reason for the paragraph (f) rule is to specify the proper filing office. Under the substantive rules of this Act, a security interest in investment property perfected only by filing is enforceable against the debtor or lien creditors, but not against most other claimants. See Sections 9-115(5) and (6), 8-105(e), 8-303, and 8-502. Because the choice of law rules in this section may, in some circumstances, have the effect of directing a court in a jurisdiction that has adopted this Act to look to the law of another jurisdiction, it is possible that the jurisdiction so specified will be one that has not adopted rules concerning the effect of filing as a method of perfection for investment property. In such cases, or other circumstances where the governing substantive law is not this Act, the effect of filing on the rights of other parties should be interpreted in light of the role of that form of perfection under this Act; that is, the rights of a secured party in investment property as determined under this Act perfected only by filing against another secured party or any other person who purchases or otherwise deals with the investment property should be interpreted to be no greater than the rights of that secured party under this Act.

The following examples illustrate these rules:

Example 1. A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law. Through the account the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer obtains a margin loan from Able. Subsection (6)(d) provides that Pennsylvania law — the law of the securities intermediary's jurisdiction — governs perfection and priority of the security interest.

Example 2. A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law. Through the account the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer obtains a loan from a lender located in Illinois. The lender takes a security interest and perfects by obtaining an agreement among the debtor, itself, and Able, which satisfies the requirement of Section 8-106(d)(2) to give the lender control. Subsection (6)(d) provides that Pennsylvania law — the law of the securities intermediary's jurisdiction — governs perfection and priority of the security interest.

Example 3. A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law. Through the account, the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer borrows from SP1, and SP1 files a financing statement in New Jersey. Later, the customer obtains a loan from SP2. SP2 takes a security interest and perfects by obtaining an agreement among the debtor, itself, and Able, which satisfies the requirement of Section 8-106(d)(2) to give the SP2 control. Subsection (6)(f) provides that perfection of SP1's security interest by filing is governed by the location of the debtor, so the filing in New Jersey was appropriate — assuming New Jersey has adopted the revisions of Article 9 permitting perfection of security interests in investment property by filing. Subsection (6)(d), however, provides that Pennsylvania law — the law of the securities intermediary's jurisdiction — governs all other questions of perfection and priority. Thus, Pennsylvania law governs perfection of SP2's security interest, and Pennsylvania law also governs the priority of the security interests of SP1 and SP2.

Cross References:

Sections 1-105, 9-302 and 9-401.

Definitional Cross References:

"Accounts"	Section 9-106.
"Attaches"	Section 9-203.

"Chattel paper"	Section 9-105.
"Collateral"	Section 9-105.
"Consumer goods"	Section 9-109.
"Debtor"	Section 9-105.
"Document"	Section 9-105.
"Equipment"	Section 9-109.
"General intangibles"	Section 9-106.
"Goods"	Section 9-105.
"Instrument"	Section 9-109.
"Purchase money security interest"	Section 9-107.
"Purchaser"	Section 1-201(33).
"Security interest"	Section 1-201(37).

Editor's Note. — Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

Effect of Amendments. — The 1997 amendment, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, rewrote subsection (6).

§ 25-9-105. Definitions and index of definitions.

(1) In this Article unless the context otherwise requires:

(a) "Account debtor" means the person who is obligated on an account, chattel paper or general intangible;

(b) "Chattel paper" means a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods, but a charter or other contract involving the use or hire of a vessel is not chattel paper. When a transaction is evidenced both by such a security agreement or a lease and by an instrument or a series of instruments, the group of writings taken together constitutes chattel paper;

(c) "Collateral" means the property subject to a security interest, and includes accounts and chattel paper which have been sold;

(d) "Debtor" means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, and includes the seller of accounts or chattel paper. Where the debtor and the owner of the collateral are not the same person, the term "debtor" means the owner of a collateral in any provision of the article dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires;

(e) "Deposit account" means a demand, time, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization, other than an account evidenced by a certificate of deposit;

(f) "Document" means document of title as defined in the general definitions of article 1 (G.S. 25-1-201), and a receipt of the kind described in subsection (2) of G.S. 25-7-201;

(g) "Encumbrance" includes real estate mortgages and other liens on real estate and all other rights in real estate that are not ownership interests;

(h) "Goods" includes all things which are movable at the time the security interest attaches or which are fixtures (G.S. 25-9-313), but does not include money, documents, instruments, investment property, accounts, chattel paper, general intangibles, or minerals or the like (including oil and gas) before extraction. "Goods" also includes standing timber which is to be cut and removed under a conveyance or contract for sale, the unborn young of animals, and growing crops;

(i) "Instrument" means a negotiable instrument (defined in G.S. 25-3-104) or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment. The term does not include investment property;

(j) "Mortgage" means a consensual interest created by a real estate mortgage, a trust deed on real estate, or the like;

(k) An advance is made "pursuant to commitment" if the secured party has bound himself to make it, whether or not a subsequent event of default or other event not within his control has relieved or may relieve him from his obligation;

(l) "Security agreement" means an agreement which creates or provides for a security interest;

(m) "Secured party" means a lender, seller or other person in whose favor there is a security interest, including a person to whom accounts or chattel paper have been sold. When the holders of obligations issued under an indenture of trust, equipment trust agreement or the like are represented by a trustee or other person, the representative is the secured party.

(2) Other definitions applying to this Article and the sections in which they appear are:

"Account." (G.S. 25-9-106).
"Attach." (G.S. 25-9-203).
"Commodity account." (G.S. 25-9-115).
"Commodity contract." (G.S. 25-9-115).
"Commodity customer." (G.S. 25-9-115).
"Commodity intermediary." (G.S. 25-9-115).
"Construction mortgage." (G.S. 25-9-313(1)).
"Consumer goods." (G.S. 25-9-109(1)).
"Control." (G.S. 25-9-115).
"Equipment." (G.S. 25-9-109(2)).
"Farm products." (G.S. 25-9-109(3)).
"Fixture." (G.S. 25-9-313(1)).
"Fixture filing." (G.S. 25-9-313(1)).
"General intangibles." (G.S. 25-9-106).
"Inventory." (G.S. 25-9-109(4)).
"Investment property." (G.S. 25-9-115).
"Lien creditor." (G.S. 25-9-301(3)).
"Proceeds." (G.S. 25-9-306(1)).
"Purchase money security interest." (G.S. 25-9-107).
"United States." (G.S. 25-9-103).

(3) The following definitions in other Articles apply to this Article:
"Broker." (G.S. 25-8-102).
"Certificated security." (G.S. 25-8-102).
"Check." (G.S. 25-3-104).
"Clearing corporation." (G.S. 25-8-102).
"Contract for sale." (G.S. 25-2-106).
"Control." (G.S. 25-8-106).
"Delivery." (G.S. 25-8-301).
"Entitlement holder." (G.S. 25-8-102).
"Financial asset." (G.S. 25-8-102).
"Holder in due course." (G.S. 25-3-302).
"Note." (G.S. 25-3-104).
"Sale." (G.S. 25-2-106).
"Securities intermediary." (G.S. 25-8-102).
"Security." (G.S. 25-8-102).
"Security certificate." (G.S. 25-8-102).
"Security entitlement." (G.S. 25-8-102).
"Uncertificated security." (G.S. 25-8-102).

(4) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article. (1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(g); 1997-181, s. 3; 1997-456, s. 4.)

OFFICIAL COMMENT

Prior Uniform Statutory Provisions: Various.

Purposes:

1. **General.** It is necessary to have a set of terms to describe the parties to a secured transaction, the agreement itself, and the property involved therein; but the selection of the set of terms applicable to any one of the existing forms (e. g., mortgagor and mortgagee) might carry to some extent the implication that the existing law referable to that form was to be used for the construction and interpretation of this Article. Since it is desired to avoid any such implication, a set of terms has been chosen which have no common law or statutory roots tying them to a particular form.

In place of such terms as "chattel mortgage," "conditional sale," "assignment of accounts receivable," "trust receipt," etc., this Article substitutes the general term "security agreement" defined in paragraph (1)(*l*). In place of "mortgagor," "mortgagee," "conditional vendee," "conditional vendor," etc., this Article substitutes "debtor", defined in paragraph (1)(d), and "secured party", defined in paragraph (1)(m). The property subject to the security agreement is "collateral", defined in paragraph (1)(c). The interest in the collateral which is conveyed by the debtor to the secured party is a "security interest", defined in Section 1-201 (37).

2. **Parties.** The parties to the security agreement are the "debtor" and the "secured party."

"Debtor": In all but a few cases the person who owes the debt and the person whose property secures the debt will be the same. Occasionally, one person furnishes security for another's debt, and sometimes property is transferred subject to a secured debt of the transferor which the transferee does not assume; in such cases, under the second sentence of the definition, the term "debtor" may, depending upon the context, include either or both such persons. Section 9-112 sets out special rules which are applicable where collateral is owned by a person who does not owe a debt.

"Secured party": The term includes any person in whose favor there is a security interest (defined in Section 1-201). The term is used equally to refer to a person who as a seller retains a lien on or title to goods sold, to a person whose interest arises initially from a loan transaction, and to an assignee of either. Note that a seller is a "secured party" in relation to his customer; the seller becomes a "debtor" if he assigns the chattel paper as collateral. This is also true of a lender who assigns the debt as collateral. With the exceptions stated in Section 9-104(f) the Article applies to any sale of accounts or chattel paper: the term "secured party" includes an assignee of such intangibles whether by sale or for security, to distinguish him from the payee of the account, for example, who becomes a "debtor" by pledging the account as security for a loan.

On the applicability of the terms "debtor" and "secured party" to consignments and leases see Section 9-408 and Comment thereto.

"Account debtor": Where the collateral is an account, chattel paper or general intangible the original obligor is called the "account debtor", defined in paragraph (1)(a).

3. **Property subject to the security agreement.** "Collateral", defined in paragraph (1)(c), is a general term for the tangible and intangible property subject to a security interest. For some purposes the Code makes distinctions between different types of collateral and therefore further classification of collateral is necessary. Collateral which consists of tangible property is "goods", defined in paragraph (1)(h); and "goods" are again subdivided in Section 9-109. For purposes of this Article all intangible collateral fits one of five categories, two of which, "accounts", and "general intangibles" are defined in the following Section 9-106; the other three, "documents", "instruments" and "chattel paper", are defined in paragraphs (1)(f), (1)(i) and (1)(b) of this section.

"Goods": The definition in paragraph (1)(h) is similar to that contained in Section 2-105 except that the Sales Article definition refers to "time of identification to the contract for sale", while this definition refers to "the time the security interest attaches".

For the treatment of fixtures, Section 9-313 should be consulted. It will be noted that the treatment of fixtures under Section 9-313 does not at all points conform to their treatment under Section 2-107 (goods to be severed from realty). Section 2-107 relates to sale of such goods; Section 9-313 to security interests in them. The discrepancies between the two sections arise from the differences in the types of interest covered. A comparable discrepancy exists as to minerals. In the case of timber, both sections treat it as goods if it is to be severed under a contract of sale, but not otherwise.

If in any state minerals before severance are deemed to be personal property, they fall outside the Article's definition of "goods" and would therefore fall in the catch-all definition, "general intangibles", in Section 9-106. The special provisions of Section 9-103(5) would not apply and those of Section 9-103(3) would apply. The resulting problems should be considered locally.

For the purpose of this Article, goods are classified as "consumer goods", "equipment", "farm products", and "inventory"; those terms are defined in Section 9-109. When the general term "goods" is used in this Article, it includes, as may be appropriate in the context, the subclasses of goods defined in Section 9-109.

"Instrument": The term as defined in paragraph (1)(i) includes not only negotiable instruments but also any other intangibles evidenced by writings which are in ordinary course of business transferred by delivery. As in the case of chattel paper "delivery" is only the minimum stated and may be accompanied by other steps.

If a writing is itself a security agreement or lease with respect to specific goods it is not an instrument although it otherwise meets the term of the definition. See Comment below on "chattel paper".

The fact that an instrument is secured by collateral, whether the collateral be other instruments, documents, goods, accounts or general intangibles, does not change the character of the principal obligation as an instrument or convert the combination of instrument and collateral into a separate Code classification of personal property. The single qualification to this principle is that an instrument which is secured by chattel paper is itself part of the chattel paper, while also retaining its identity as an instrument.

"Document": See the Comments under Sections 1-201(15) and 7-201.

"Chattel paper": To secure his own financing a secured party may wish to borrow against or sell the security agreement itself along with his interest in the collateral which he has received from his debtor. Since the refinancing of paper secured by specific goods presents some problems of its own, the term "chattel paper" is used to describe this kind of collateral. The Comments under Section 9-308 further describe this concept.

Charters of vessels are excluded from the definition of chattel paper because they fit under the definition of accounts. See Comment to Section 9-106. The term "charter" as used herein and in Section 9-106 includes bareboat charters, time charters, successive voyage charters, contracts of affreightment, contracts of carriage, and all other arrangements for use of vessels.

4. The following transactions illustrate the use of the term "chattel paper" and some of the other terms defined in this section.

A dealer sells a tractor to a farmer on conditional sales contract or purchase money security interest. The conditional sales contract is a "security agreement", the farmer is the "debtor", the dealer is the "secured party" and the tractor is the type of "collateral" defined in Section 9-109 as "equipment". But now the dealer transfers the contract to his bank, either by outright sale or to secure a loan. Since the conditional sales contract is a security agreement relating to specific equipment, the conditional sales contract is now the type of collateral called "chattel paper". In this transaction between the dealer and his bank, the bank is the "secured party", the dealer is the "debtor", and the farmer is the "account debtor".

Under the definition of "security interest" in Section 1-201(37) a lease does not create a security interest unless intended as security. Whether or not the lease itself is a security agreement, it is chattel paper when transferred if it relates to specific goods. Thus, if the dealer enters into a straight lease of the tractor to the farmer (not intended as security), and then arranges to borrow money on the security of the lease, the lease is chattel paper.

Security agreements of the type formerly known as chattel mortgages and conditional sales contracts are frequently executed in connection with a negotiable note or a series of such notes. Under the definitions in paragraphs (1)(b) and (1)(i) the rules applicable to chattel paper, rather than those relating to instruments, are applicable to the group of writings (contract plus note) taken together.

5. **Miscellaneous definitions.**

"Deposit account" is a type of collateral excluded from this Article under Section 9-104(*l*), except when it constitutes proceeds of other collateral under Section 9-306.

The terms "encumbrance" and "mortgage" are defined for use in the section on fixtures, Section 9-113.

The term "transmitting utility" is defined to designate a special class of debtors for whom separate filing rules are provided in Part 4, thus obviating all local filing and particularly the several local filings that would be necessary under the usual rules of Section 9-401 for the fixture collateral of a far-flung public utility debtor. See Comments under Sections 9-401 and 9-403.

The term "pursuant to commitment" is defined for use in the rules relating to priority of future advances in Sections 9-301(4), 9-307(3), and 9-312(7).

6. Comments to the definitions indexed in subsections (2) and (3) follow the sections in which the definitions are contained.

Cross References:

Point 2: Sections 9-104(f) and 9-112.

Point 3: Sections 2-105, 2-107, 9-106, 9-109, 9-303 and 9-313.

Definitional Cross References:

"Account"	Section 9-106.
"Agreement"	Section 1-201.
"Document of title"	Sections 1-201, 7-201.
"General intangibles"	Section 9-106.
"Holder"	Section 1-201.
"Money"	Section 1-201.
"Negotiable instrument"	Section 3-104.
"Person"	Section 1-201.
"Representative"	Section 1-201.
"Rights"	Section 1-201.
"Security"	Section 8-102.
"Security interest"	Section 1-201.
"Writing"	Section 1-201.

Editor's Note. —

Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

Effect of Amendments. — Session Laws 1997-181, s. 3, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, inserted "investment property, commodity contracts" in subdivision (1)(h); and in subdivision (1)(i) substituted "(defined in G.S. 25-3-104)" for "(defined in G.S. 25-3-104) or a certificated security (defined in G.S. 25-8-102)" and added "The term does not include investment property"; and rewrote subsection (2).

Session Laws 1997-456, s. 4, effective August 29, 1997, deleted "commodity contracts" following "investment property" in subsection (h).

CASE NOTES

Cited in Roberts v. First-Citizens Bank & Trust Co., 124 N.C. App. 713, 478 S.E.2d 809 (1996); Dowell v. D.R. Kincaid Chair Co., 125 N.C. App. 557, 481 S.E.2d 670 (1997).

§ 25-9-106. Definitions: "Account"; "general intangibles."

"Account" means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance. "General intangibles" means any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, investment property, and money. All rights to payment earned or unearned under a charter or other contract involving the use or hire of a vessel and all rights incident to the charter or contract are accounts. (1945, c. 196, s. 1; 1957, c. 504; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1997-181, s. 4.)

Editor's Note. — Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

Effect of Amendments. — The 1997 amendment, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, inserted "investment property."

§ 25-9-110. Sufficiency of description.

CASE NOTES

Description Held Sufficient. — Where the security agreement described the collateral as all dairy cattle proceeds and accounts receivable resulting from milk sales and the site of the farm, this description reasonably identified the collateral. Mountain Farm Credit Serv. v. Purina Mills, Inc., 119 N.C. App. 508, 459 S.E.2d 75 (1995).

§ 25-9-115. Investment property.

(1) In this Article:

(a) "Commodity account" means an account maintained by a commodity intermediary in which a commodity contract is carried for a commodity customer.

(b) "Commodity contract" means a commodity futures contract, an option on a commodity futures contract, a commodity option, or other contract that, in each case, is:

(i) Traded on or subject to the rules of a board of trade that has been designated as a contract market for such a contract pursuant to the federal commodities laws: or

(ii) Traded on a foreign commodity board of trade, exchange, or market, and is carried on the books of a commodity intermediary for a commodity customer.

(c) "Commodity customer" means a person for whom a commodity intermediary carries a commodity contract on its books.

(d) "Commodity intermediary" means:

(i) A person who is registered as a futures commission merchant under the federal commodities laws: or

(ii) A person who in the ordinary course of its business provides clearance or settlement services for a board of trade that has been designated as a contract market pursuant to the federal commodities laws.

(e) "Control" with respect to a certificated security, uncertificated security, or security entitlement has the meaning specified in G.S. 25-8-106. A secured party has control over a commodity contract if by agreement among the commodity customer, the commodity intermediary, and the secured party, the commodity intermediary has agreed that it will apply any value distributed on account of the commodity contract as directed by the secured party without further consent by the commodity customer. If a commodity customer grants a security interest in a commodity contract to its own commodity intermediary, the commodity intermediary as secured party has control. A secured party has control over a securities account or commodity account if the secured party has control over all security entitlements or commodity contracts carried in the securities account or commodity account.

(f) "Investment property" means:

(i) A security, whether certificated or uncertificated;

(ii) A security entitlement;

(iii) A securities account;

(iv) A commodity contract; or

(v) A commodity account.

(2) Attachment or perfection of a security interest in a securities account is also attachment or perfection of a security interest in all security entitlements carried in the securities account. Attachment or perfection of a security interest in a commodity account is also attachment or perfection of a security interest in all commodity contracts carried in the commodity account.

(3) A description of collateral in a security agreement or financing statement is sufficient to create or perfect a security interest in a certificated security, uncertificated security, security entitlement, securities account, commodity contract, or commodity account

whether it describes the collateral by those terms, or as investment property, or by description of the underlying security, financial asset, or commodity contract. A description of investment property collateral in a security agreement or financing statement is sufficient if it identifies the collateral by specific listing, by category, by quantity, by a computational or allocational formula or procedure, or by any other method, if the identity of the collateral is objectively determinable.

(4) Perfection of a security interest in investment property is governed by the following rules:

(a) A security interest in investment property may be perfected by control.

(b) Except as otherwise provided in paragraphs (c) and (d), a security interest in investment property may be perfected by filing.

(c) If the debtor is a broker or securities intermediary, a security interest in investment property is perfected when it attaches. The filing of a financing statement with respect to a security interest in investment property granted by a broker or securities intermediary has no effect for purposes of perfection or priority with respect to that security interest.

(d) If a debtor is a commodity intermediary, a security interest in a commodity contract or a commodity account is perfected when it attaches. The filing of a financing statement with respect to a security interest in a commodity contract or a commodity account granted by a commodity intermediary has no effect for purposes of perfection or priority with respect to that security interest.

(5) Priority between conflicting security interests in the same investment property is governed by the following rules:

(a) A security interest of a secured party who has control over investment property has priority over a security interest of a secured party who does not have control over the investment property.

(b) Except as otherwise provided in paragraphs (c) and (d), conflicting security interests of secured parties each of whom has control rank equally.

(c) Except as otherwise agreed by the securities intermediary, a security interest in a security entitlement or a securities account granted to the debtor's own securities intermediary has priority over any security interest granted by the debtor to another secured party.

(d) Except as otherwise agreed by the commodity intermediary, a security interest in a commodity contract or a commodity account granted to the debtor's own commodity intermediary has priority over any security interest granted by the debtor to another secured party.

(e) Conflicting security interests granted by a broker, a securities intermediary, or a commodity intermediary which are perfected without control rank equally.

(f) In all other cases, priority between conflicting security interests in investment property is governed by G.S. 25-9-312(5), (6), and (7). G.S. 25-9-312(4) does not apply to investment property.

(6) If a security certificate in registered form is delivered to a secured party pursuant to agreement, a written security agreement

is not required for attachment or enforceability of the secured interest, delivery suffices for perfection of the security interest, and the security interest has priority over a conflicting security interest perfected by means other than control, even if a necessary indorsement is lacking. (1997-181, s. 5.)

OFFICIAL COMMENT

1. **Overview.** This section sets out the principal rules on security interests in investment property. Investment property, defined in subsection (1)(f) is a new term for a category of collateral that includes securities, whether held directly or through intermediaries, and commodity futures. The term investment property is used in Article 9 as one of the general categories of collateral, such as goods or instruments. Investment property is excluded from the definitions of goods, instruments, and general intangibles. See Sections 9-105(1)(h), 9-105(1)(i), and 9-106.

This section is added as part of the revision of Article 8 on investment securities. It relies in part on terms and concepts defined in Revised Article 8. Prior to the 1978 amendments to Article 8, the rules on security interests in securities were included in Article 9. The 1978 amendments moved the key rules to Article 8. The revision of Article 8 returns these matters to Article 9. In order to avoid disruption of section numbering, the new rules on security interests in investment property are collected in this section, rather than being distributed among the various sections of Article 9 dealing with corresponding issues for other categories of collateral. On matters not covered by rules set out in this section, security interests in investment property are governed by the general rules in other sections of this Article.

The distinction between the direct and indirect holding systems plays an important role in the rules on security interests in securities. Consider two investors, X and Y, each of whom owns 1000 shares of XYZ Co. common stock. X has a certificate representing 1000 shares and is registered on the books maintained by XYZ Co.'s transfer agent as the holder of record of those 1000 shares. X has a direct relationship with the issuer, and receives dividends, distributions, and proxies directly from the issuer. In Revised Article 8 terminology, X has a direct claim to a "certificated security." If X wishes to use the investment position as collateral for a loan, X would grant the lender a security interest in the "certificated security." The Article 9 rules for such transactions are explained in Comment 2. XYZ Co. might not issue certificates, but register investors such as X directly on its stockholder books. In that case, X's interest would be an "uncertificated security." The Article 9 rules for uncertificated securities are explained in Comment 3. By contrast to these direct relationships, Y holds the securities through an account with Y's broker. Y does not have a certificate and is not registered on XYZ Co.'s stock books as a holder of record. Rather, Y holds the securities through a chain of securities intermediaries. Under Revised Article 8, Y's interest in XYZ common stock is described as a "securities entitlement." If Y wishes to use the investment position as collateral for a loan, Y would grant the lender a security interest in the "securities entitlement." The Article 9 rules for security entitlements are explained in Comment 4.

A commercial setting in which security interests in investment property play a most economically significant role is the "wholesale" level, that is, finance of securities firms and security interests that support the extension of credit in the settlement system. Comments 6 and 7 deal with these transactions. The rules on security interests in investment property also apply to commodity futures. Comment 8 deals with these transactions.

The rules on security interests in investment property are based on the concept of "control," defined in Sections 8-106 and 9-115(1)(e). If the secured party has control the security interest can attach even without a written security agreement. See Section 9-203. A security interest in investment property can also be created by a written security agreement pursuant to Section 9-203. Security interests in investment property can be perfected by control. See subsection (4)(a). Although other methods of perfection are also permitted, the basic priority rule, set out in subsection (5)(a), is that a secured party who obtains control has priority over a secured party who relies on some other method of perfection. The control priority rule is explained in Comment 5.

2. **Security interests in certificated securities.** A security interest in a certificated security can be created by conferring control on the secured party. Section 8-106 provides that a secured party has control of a certificated security if the certificate has been delivered, see Section 8-301, and any necessary indorsement has been supplied. Section 9-203 provides that a security interest can attach, even without a written security agreement, if the secured party has control. Section 9-115(4)(a) provides that control is a permissible method of perfection.

A security interest in a certificated security can also be created by a written security agreement pursuant to Section 9-203, and can be perfected by filing, see subsection (4)(b). (The perfection by filing rule does not apply if the debtor is a broker or securities intermediary.) However, a security interest perfected only by filing is subordinate to a conflicting security interest perfected by control. See subsection (5)(a) and Comment 5. Also, perfection by filing would not give the secured party protection against other types of adverse claims, since the Article 8 adverse claim cut-off rules require control. See Section 8-510.

Section 9-115(6) deals with cases where a secured party has taken possession of an unindorsed security certificate in registered form. It provides that even though the indorsement is lacking, delivery of the certificate to the secured party suffices for attachment and perfection of the security interest in the certificated security. It also provides that such a possessory security interest has priority over a conflicting non-control security interest, such as a security interest perfected by filing. However, without the indorsement the secured party would not get the other protections against adverse claims that flow from obtaining control. See Section 8-510.

3. **Security interests in uncertificated securities.** The rules on security interests in uncertificated securities apply only where the debtor is the direct holder of an uncertificated security. For example, mutual funds typically do not issue certificates, but the beneficial owners of mutual funds shares commonly are the direct holders of the shares, whose interests are recorded on the books of the issuer. If such an investor grants a security interest in the mutual funds shares, the rules in this section on security interests in uncertificated securities apply. These rules are not germane to situations where a debtor holds securities through a securities intermediary. Security interests in positions held through securities intermediaries are governed by the rules on security entitlements and securities accounts not the rules on uncertificated securities.

A security interest in an uncertificated security can be perfected either by control or by filing. See subsection (4)(a) and (b). (The filing rule does not apply if the debtor is itself a broker or securities intermediary.) Priority disputes among conflicting security interests in an uncertificated security are governed by subsection (5). Under subsection (5)(a), a secured party who obtains control has priority over a secured party who does not have control. Thus, although filing is a permissible method of perfection, a secured party who perfects by filing takes the risk that the debtor has granted or will grant a security interest in the same property to another party who obtains control. See Comment 5.

The requirements for control with respect to uncertificated securities are set out in Section 8-106(c). There are two possibilities. First, a secured party has control if the uncertificated security is transferred from debtor to secured party on the books of the issuer. See Sections 8-106(c)(1) (control by "delivery") and 8-301(b) (defining "delivery" of uncertificated security). So far as the issuer is concerned, the secured party is the registered owner entitled to all rights of ownership, though as between the debtor and secured party the debtor remains the owner and the secured party holds its interest as secured party. Second, a secured party has control over an uncertificated security if the issuer agrees that it will comply with "instructions" originated by the secured party without further consent by the registered owner. See Section 8-106(c)(2). If the debtor, secured party, and issuer agree that the secured party has the right to direct the issuer to dispose of the security without further action by the debtor, the secured party has control even though the debtor remains listed as the registered owner and continues to receive dividends and distributions. Note, though, that there is no statutory requirement that issuers of uncertificated securities offer such arrangements.

4. **Security interests in security**

entitlements and securities accounts. This section establishes a structure for creating security interests in securities and other financial assets that a debtor holds through an account with a securities intermediary. Under Revised Article 8, the interest of a person who holds securities through a securities account with a broker or other securities intermediary is described as a security entitlement. Thus, the Article 9 rules governing the use of that person's investment position as collateral are the rules for security entitlements and securities accounts, not the rules for certificated securities or uncertificated securities.

Attachment of security interests in security entitlements and securities accounts is governed by Section 9-203 and subsections (2) and (3) of this section. Unless the secured party has control, a written security agreement is necessary for attachment. For purposes of description of the collateral in a security agreement, it is not essential that the precise Article 8 terminology be used. See subsection (3). For example, if a debtor who holds 1000 shares of XYZ Co. common stock through a securities account signs a security agreement which describes the collateral as "1000 shares of XYZ Co. common stock," that description is sufficient, even though the debtor's interest would be described under Revised Article 8 as a "security entitlement" to 1000 shares of XYZ Co. common stock.

The Article 8 term security entitlement also covers the interest of a person in a "financial asset," if the person holds that financial asset through a securities account. "Financial asset" is a broader term than "security." See Section 8-102(a)(9). For example, a bankers' acceptance is an Article 3 negotiable instrument and hence an instrument under Section 9-105(1)(i). If a person who holds a bankers' acceptance directly wishes to grant a security interest in it, the Article 9 rules for instruments apply. However, if a person holds a bankers' acceptance through a securities account, the person has a security entitlement to the bankers' acceptance. If the person wishes to grant a security interest in the security entitlement to the bankers' acceptance, the Article 9 rules for investment property apply.

Subsection (1)(f)(iii) provides that the term investment property also includes "securities account." This is intended to facilitate transactions in which a debtor wishes to grant a security interest in all of the investment positions held through a particular account rather than in particular positions carried in the account. Just as a debtor may grant a security interest either in specifically listed items of equipment or in all of the debtor's equipment, so too a debtor who holds securities or other financial assets through a securities account may grant a security interest either in specifically listed security entitlements or in all of the security entitlements held through that account. Referring to the collateral as the securities account is a simple way of describing all of the security entitlements carried in the account. Section 9-115(2) provides that attachment or perfection of a security interest in a securities account is also attachment or perfection of a security interest in all security entitlements carried in the securities account. A security interest in a securities account would also include all other rights of the debtor against the securities intermediary arising out of the securities account. For example, a security interest in a securities account would include credit balances due to the debtor from the securities intermediary, whether or not they are proceeds of a security entitlement.

A security interest in a security entitlement or securities account can be perfected either by control or by filing. See subsections (4)(a) and (4)(b), (The filing rule does not apply if the debtor is itself a broker or securities intermediary.) Priority disputes among conflicting security interests in a security entitlement or securities account are governed by subsection (5). The basic rule of subsection (5)(a) is that a secured party who obtains control has priority over a secured party who does not have control. Thus, although filing is a permissible method of perfection, a secured party who perfects by filing takes the risk that the debtor has granted or will grant a security interest in the same property to another party who obtains control. See Comment 5.

The requirements for control with respect to security entitlements and securities accounts are set out in Sections 8-106(d) and 9-115(1)(e). There are two possibilities. First, Section 8-106(d)(1) provides that a secured party has control over a security entitlement if the secured party becomes the entitlement holder, that is, the position is transferred from debtor to secured party on the books of a securities intermediary. See Examples 1 and 2 in Comment 4 to Section 8-106. Second, Section 8-106(d)(2) provides that a secured party has control over a security entitlement if the securities intermediary agrees that it will comply with entitlement orders originated by the secured party without further consent by the debtor. See Example 3 in Comment 4 to Section 8-106. If the debtor, secured party, and issuer agree that the secured party has the right to direct the securities intermediary to dispose of the collateral without further action by the debtor, the secured party has control even though the debtor remains listed as the entitlement holder and continues to receive dividends and distributions. The secured party can obtain control even though the debtor is also allowed to continue to trade. See Section 8-106(f) and Comment 7 thereto. The three-party control agreement device is based on arrangements that have already developed in the securities business. Even under prior law, some securities brokers developed standard forms of such agreements. Note though that, as is the case with respect to issuers of uncertificated securities, there is no statutory requirement that securities intermediaries offer such control agreement arrangements.

Subsection (1)(e) provides that a secured party has control over a securities account if it has control over all security entitlements carried in the account. Thus, the rules in Section 8-106(d) on control with respect to security entitlements determine whether a secured party has control over a securities account. Control with respect to a securities account is defined in terms of obtaining control over the security entitlements simply for drafting convenience. Of course, an agreement that provides that the securities intermediary will honor instructions from the secured party concerning a securities account described as such is sufficient since such an agreement necessary implies that the secured party has control over all security entitlements carried in the account.

If a customer borrows from its own securities intermediary, e.g., to purchase securities "on margin" or for other purposes, and grants a security interest to its intermediary, the intermediary has control. See Section 8-106(e). A securities firm could also provide control financing arrangements to its customers through a different legal entity than the securities intermediary itself, e.g., the securities trading, custody, and credit services might be provided by different corporate entities within the financial services firm's "family." So long as the agreement with the customer provides that the entity providing the custodial function (the "securities intermediary") will act on instructions received from entity providing the credit, the credit entity has control.

5. **Priority rules.** Subsection (5) specifies the priority rules for conflicting security interests in the same investment property. Subsection (5)(a) states the most important general rule —— that a secured party who obtains control has priority over a secured party who does not obtain control. The other priority rules, in subsections (5)(b) through (5)(e), deal with relatively unusual circumstances not covered by the control priority rule. Subsection (5)(f) provides that the general priority rules of Section 9-312 apply to cases not covered by the specific rules in subsection (5). The principal application of this residual rule is that the usual first in time of filing rule applies to conflicting security interests that are perfected only by filing. Because the control priority rule of subsection (5)(a) provides for the ordinary cases in which persons purchase securities on margin credit from their brokers, there is no need for special rules for purchase money security interests. Accordingly subsection (5)(f) provides that the purchase money priority rule of Section 9-312(4) does not apply to investment property.

The following examples illustrate the basic priority rules of this section:

Example 1. Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock for which Debtor has a certificate. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor delivers the certificate, properly indorsed, to Beta. Alpha and Beta both have perfected security interests in the XYZ Co. stock. Beta has control, see Section 8-106(b)(1), and hence has priority over Alpha.

Example 2. Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, held through a securities account with Able & Co. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor instructs Able to have the 1000 shares transferred through the clearing corporation to Custodian Bank, to be credited to Beta's account with Custodian Bank. Alpha and Beta both have perfected security interests in the XYZ Co. stock. Beta has control, see Section 8-106(d)(1), and hence has priority over Alpha.

Example 3. Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, which is held through a securities account with Able & Co. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Alpha and Beta both have perfected security interests in the XYZ Co. stock. Beta has control, see Section 8-106(d)(2), and hence has priority over Alpha.

Example 4. Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, held through a securities account with Able & Co. Alpha perfects by filing. Debtor's agreement with Able & Co. provides that Able has a security interest in all securities carried in the account as security for any obligations of Debtor to Able. Debtor incurs obligations to Able and later defaults on the obligations to Alpha and Able. Able has control by virtue of the rule of Section 8-106(e) that if a customer grants a security interest to its own intermediary, the intermediary has control. Since Alpha does not have control, Able has priority over Alpha under the general control priority rule of subsection (5)(a).

Example 5. Debtor holds securities through a securities account with Able & Co. Debtor's agreement with Able & Co. provides that Able has a security interest in all securities carried in the account as security for any obligations of Debtor to Able. Debtor borrows from Beta and grants Beta a security interest in 1000 shares of XYZ Co. stock carried in the account. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Debtor incurs obligations to Able and later defaults on the obligations to Beta and Able. Both Beta and Able have control, so the general control priority rule of subsection (5)(a) does not apply. Compare Example 4. Subsection (5)(c) provides that a security interest held by a securities intermediary in positions of its own customer has priority over a conflicting security interest of an external lender, so Able has priority over Beta. (Subsection (5)(d) has a parallel rule for commodities intermediaries.) The agreement among Able, Beta, and Debtor could, of course, determine the relative priority of the security interests of Able and Beta, see Section 9-316, but the fact that the intermediary has agreed to act on the instructions of a secured party such as Beta does not itself imply any agreement by the intermediary to subordinate.

The control priority rule does not turn on either temporal sequence or awareness of conflicting security interests. Rather, it is a structural rule, based on the principle that a lender should be able to rely on the collateral without question if the lender has taken the necessary steps to assure itself that it is in a position where it can foreclose on the collateral without further action by the debtor. The control priority rule is necessary because the perfection rules provide considerable flexibility in structuring secured financing arrangements. For example, at the "retail" level, a secured lender to an investor who wants the full measure of protection can obtain control, but the creditor may be willing to accept the greater measure of risk that follows from perfection by filing. Similarly, at the "wholesale" level, a lender to securities firms can leave the collateral with the debtor and obtain a perfected security interest under the automatic perfection rule of subsection (4)(c), but a lender who wants to be entirely sure of its position will want to obtain control. The control priority rule of subsection (5)(a) is an essential part of this system of flexibility. It is feasible to provide more than one method of perfecting secured transactions only if the rules ensure that those who take the necessary steps to obtain the full measure of protection do not run the risk of subordination to those who have not taken such steps. A secured party who is unwilling to run the risk that the debtor has granted or will grant a conflicting control security interest should not make a loan without obtaining control of the collateral.

As applied to the retail level, the control priority rule means that a secured party who obtains control has priority over a conflicting security interest perfected by filing without regard to inquiry into whether the control secured party was aware of the filed security interest. Prior to enactment of this section, Article 9 did not permit perfection of security interests in securities by filing. Accordingly, parties who deal in securities have never developed a practice of searching the UCC files before conducting securities transactions. Although filing is now a permissible method of perfection, in order to avoid disruption of existing practices in this business it is necessary to give perfection by filing a different and more limited effect for securities than for some other forms of collateral. The priority rules are not based on the assumption that parties who perfect by the usual method of obtaining control will search the files. Quite the contrary, the control priority rule is intended to ensure that secured parties who do obtain control are entirely unaffected by filings. To state the point another way, perfection by filing is intended to affect only general creditors or other secured creditors who rely on filing. The rule that a security interest perfected by filing can be primed by a control security interest, without regard to awareness, is a consequence of the system of perfection and priority rules for investment property. These rules are designed to take account of the circumstances of the securities markets, where filing is not given the same effect as for some other forms of property. No implication is made about the effect of filing with respect to security interests in other forms of property, nor about other Article 9 rules, e.g., Section 9-308, which govern the circumstances in which security interests in other forms of property perfected by filing can be primed by subsequent perfected security interests.

6. **Secured finance of securities firms.** Modernization of the commercial law rules governing secured finance of securities dealers and security interest arrangements in the clearance and settlement system is essential to the safe and efficient functioning of the securities markets.

Secured financing arrangements for securities firms are currently implemented in various ways. In some circumstances lenders may require that the transactions be structured as "hard pledges," where the securities are transferred on the books of a clearing corporation from the debtor's account to the lender's account or to a special pledge account for the lender where they cannot be disposed of without the specific consent of the lender. In other circumstances, lenders are content with so-called "agreement to pledge" or "agreement to deliver" arrangements, where the debtor retains the positions in its own account, but reflects on its books that the positions have been hypothecated and promises that the securities will be transferred to the secured party's account on demand.

The perfection and priority rules of this section are designed to facilitate current secured financing arrangements for securities firms as well as to provide sufficient flexibility to accommodate new arrangements that develop in the future. Hard pledge arrangements are covered by the concept of control. If the lender obtains control, the security interest is perfected and has priority over a conflicting non-control security interest. For examples of control arrangements in this setting see Examples 4 through 8 in Comment 4 to Section 8-106. The secured party can obtain control even though the debtor retains the right to trade or otherwise dispose of the collateral. See Section 8-106(f) and Examples 7 and 8 in Comment 4 to Section 8-106.

Noncontrol secured financing arrangements for securities firms are covered by the automatic perfection rule of subsection (4)(c). Under prior law, agreement to pledge arrangements could be implemented under a provision that a security interest in securities given for new value under a written security agreement was perfected without filing or possession for a period of 21 days. Although the security interests were temporary in legal theory, the financing arrangements could, in practice, be continued indefinitely by rolling over the loans at least every 21 days. Accordingly, a knowledgeable creditor of a securities firm realizes that the firm's securities may be subject to security interests that are not discoverable from any public records. The perfection rule of subsection (4)(c) makes it unnecessary to engage in the purely formal practice of rolling over these arrangements every 21 days.

Priority questions concerning security interests granted by brokers and securities intermediaries are governed by the general control priority rule of subsection (5)(a), as supplemented by the special rules set out in subsections (b), (c), and (e). In cases not covered by the control priority rule, conflicting security interests rank equally. The following examples illustrate the priority rules as applied to this setting. (In all cases it is assumed that the debtor retains sufficient other securities to satisfy all customers' claims. This section deals with the relative rights of secured lenders to a securities firm. Disputes between a secured lender and the firm's own customers are governed by Section 8-511.)

Example 6. Able & Co., a securities dealer, enters into financing arrangements with two lenders, Alpha Bank and Beta Bank. In each case the agreements provide that the lender will have a security interest in the securities identified on lists provided to the lender on a daily basis, that the debtor will deliver the securities to the lender on demand, and that the debtor will not list as collateral any securities which the debtor has pledged to any other lender. Upon Able's insolvency it is discovered that Able has listed the same securities on the collateral lists provided to both Alpha and Beta. Alpha and Beta both have perfected security interests under the automatic perfection rule of subsection (4)(c). Neither Alpha nor Beta has control. Subsection (5)(e) provides that the security interests of Alpha and Beta rank equally, because each of them has a non-control security interest granted by a securities firm. They share pro rata.

Example 7. Able enters into financing arrangements with Alpha Bank and Beta Bank as in Example 6. At some point, however, Beta decides that it is unwilling to continue to provide financing on a non-control basis. Able directs the clearing corporation where it holds its principal inventory of securities to move specified securities into Beta's account. Upon Able's insolvency it is discovered that a list of collateral provided to Alpha includes securities that had been moved to Beta's account. Both Alpha and Beta have perfected security interests; Alpha under the automatic perfection rule of subsection (4)(c), and Beta under that rule and also the subsection (4)(a) control perfection rule. Beta has control but Alpha does not. Beta has priority over Alpha under subsection (5)(a).

Example 8. Able & Co. carries its principal inventory of securities through Clearing Corporation, which offers a "shared control" facility whereby a participant securities firm can enter into an arrangement with a lender under which the securities firm will retain the power to trade and otherwise direct dispositions of securities carried in its account, but Clearing Corporation agrees that, at any time the lender so directs, Clearing Corporation will transfer any securities from the firm's account to the lender's account or otherwise dispose of them as directed by the lender. Able enters into financing arrangements with two lenders, Alpha and Beta, each of which obtains such a control agreement from Clearing Corporation. The agreement with each lender provides that Able will designate specific securities as collateral on lists provided to the lender on a daily or other periodic basis, and that it will not pledge the same securities to different lenders. Upon Able's insolvency, it is discovered that Able has listed the same securities on the collateral lists provided to both Alpha and Beta. Both Alpha and Beta have control over the disputed securities. They share pro rata under subsection (5)(b).

7. **Secured financing arrangement in the settlement system.** Under the rules or agreements governing the relationship between a clearing corporation and its participants, the clearing corporation may have a security interest in securities that the participants have deposited with the clearing corporation pursuant to guaranty fund arrangements or in securities that are in the process of delivery to or from a participant's account in the settlement process. The control rules protect the clearing corporation's rights as secured party in such arrangements, since the clearing corporation would have control over the collateral under the Section 8-106 rules. The control rules also protect the rights of "upper-tier" intermediaries that are not themselves clearing corporations. For example, if a securities dealer carries its inventory through a clearing bank that provides both custodial and credit services, the clearing bank as secured party would have control and hence be assured of perfection and prior-

ity over any potential conflicting security interests granted by the securities dealer.

In some circumstances, a clearing corporation may be the debtor in a secured financing arrangement. For example, a clearing corporation that settles delivery-versus-payment transactions among its participants on a net, same-day basis relies on timely payments from all participants with net obligations due to the system. If a participant that is a net debtor were to default on its payment obligation, the clearing corporation would not receive some of the funds needed to settle with participants that are net creditors to the system. To complete end-of-day settlement after a payment default by a participant, a clearing corporation that settles on a net, same-day basis may need to draw on credit lines and pledge securities of the defaulting participant or other securities pledged by participants in the clearing corporation to secure such drawings. The clearing corporation may be the top tier securities intermediary for the securities pledged, so that it would not be practical for the lender to obtain control. Even where the clearing corporation holds some types of securities through other intermediaries, however, the clearing corporation is unlikely to be able to complete the arrangements necessary to convey "control" over the securities to be pledged in time to complete settlement in a timely manner. However, the term "securities intermediary" is defined in Section 8-102(a)(14) to include clearing corporations. Thus, the perfection rule of subsection (4)(c) applies to security interests in investment property granted by clearing corporations.

In secured financing arrangements for clearing corporations and other securities intermediaries, it is sometimes necessary to specify that a secured lender will have a security interest in a certain bundle of securities that, after all the calculations necessary to complete a processing cycle are completed, turn out to be appropriate and available for pledge. At the time the security interest attaches, the necessary computations may not have been completed, though the information that ultimately will determine what positions are to be pledged has been entered. Accordingly, subsection (3) provides that the description of collateral in a security agreement may identify the collateral by means of a computational or allocational formula.

8. **Security interests in commodity futures.** Section 9-115 establishes rules on security interests in commodity contracts and commodity accounts that are, in general, parallel to the rules on security interests in security entitlements and securities accounts. Note, though, that commodity contracts are not "securities" or "financial assets" under Article 8. See Section 8-103(f). Thus, the relationship between commodity intermediaries and commodity customers is not governed by the indirect holding system rules in Part 5 of Article 8. For securities, the UCC establishes rules in Article 9 rules on security interests, and rules in Article 8 on the rights of transferees, including secured parties, on such matters as the rights of a transferee if the transfer was itself wrongful so that another party has an adverse claim. For commodity contracts, Article 9 establishes rules on security interests, but questions of the sort dealt with in Article 8 for securities are left to other law.

Subsection (1) contains the definitions of the terms used in substantive rules on security interests in commodity contracts and commodity accounts. The key term "commodity contract" is defined in subsection (1)(b). Section 8-103(f) provides that a commodity contract, as defined in Section 9-115, is not a security or a financial asset. The result is that the indirect holding system rules in Revised Article 8 Part 5 do not apply to anything that falls within the definition of commodity contract in this section. The indirect holding system rules of Article 8, however, are intended to be sufficiently flexible that they can be applied to new developments in the securities and financial markets, where that is appropriate. Accordingly, the "commodity contract" definition in this section is narrowly drafted to ensure that it does not operate as an obstacle to the application of the new Article 8 indirect holding system rules to new products. The term commodity contract covers those contracts that are traded on or subject to the rules of a designated contract market, and foreign commodity contracts that are carried on the books of American commodity intermediaries. The effect of this definition is that the category of commodity contracts that are excluded from Article 8 but governed by Article 9 is essentially the same as the category of contracts that fall within the exclusive regulatory jurisdiction of the federal Commodities Futures Trading Commission.

Commodity contracts are rather different from securities or other financial assets. A person who enters into a commodity futures contract is not buying an asset having a certain value and holding it in anticipation of increase in value. Rather the person is entering into a contract to buy or sell a commodity at set price for delivery at a future time. That contract may become advantageous or disadvantageous as the price of the commodity fluctuates during the term of the contract. The rules of the commodity exchanges require that the contracts be marked to market on a daily basis, that is the customer pays or receives any increment attributable to that day's price change. Because commodity customers may incur obligations on their contracts, they are required to provide collateral at the outset, known as "original margin," and may be required to provide additional amounts, known as "variation margin," during the term of the contract.

The most likely setting in which a person would want to take a security interest in a commodity contract is where a lender who is advancing funds to finance an inventory of a physical commodity requires the borrower to enter into a commodity contract as a hedge against the risk of decline in the value of the commodity. The lender will want to take a security interest in both the commodity itself and the hedging commodity contract. Typically, such arrangements are structured as security interests in the entire commodity account in which the borrower carries the hedging contracts, rather than in individual contracts. Section 9-115 provides a simple mechanism for implementation of such arrangements, either by granting a security interest in the commodity account, or in particular commodity contracts carried in the account. The security interest can be perfected by filing or by control. Under subsection (1)(e) the secured party can obtain control over a commodity contract or commodity account by obtaining an agreement among the commodity customer, the secured party, and the commodity intermediary in which the commodity intermediary agrees to apply any value distributed as directed by the secured party. This provides a clear and certain legal framework for practices that have already developed in the industry.

One important effect of including commodity contracts and commodity accounts in the new Article 9 rules is to provide a clearer legal structure for the analysis of the rights of commodity clearing organizations against their participants and futures commission merchants against their customers. The rules and agreements of commodity clearing organizations generally provide that the clearing organization has the right to liquidate any participant's positions in order to satisfy obligations of the participant to the clearing corporation. Similarly, agreements between futures commission merchants and their customers generally provide that the futures commission merchant has the right to liquidate a customer's positions in order to satisfy obligations of the customer to the futures commission merchant. Section 9-115 treats these rights as security interests and applies to them the same priority rules that apply to the somewhat analogous relationships between securities clearing corporations or securities intermediaries and their participants or customers. Subsection (1)(e) provides that the commodity intermediary has control, and therefor the security interest is perfected under subsection (4)(a). Subsection (5)(d) provides that the security interest of a commodity clearing organization in its participant's commodity contracts has priority over any security interest granted by the participant to a third-party lender. Similarly, an FCM's security interest would have priority over any security interest granted by its customer to a third-party lender.

The main property that a commodity intermediary holds as collateral for the obligations that the commodity customer may incur under its commodity contracts is not other commodity contracts carried by the customer but the other property that the customer has posted as margin. Typically, this property will be securities. The commodity intermediary's security interest in such securities is governed by the rules of this section on security interests in securities not the rules on security interests in commodity contracts or commodity accounts.

Although there are significant analytic and regulatory differences between commodities and securities, the development of commodity contracts on financial products in the past few decades has resulted in a system in which the commodity markets and security markets are closely linked. The Section 9-115 rules on security interests in commodity contracts and commodity accounts provide a structure that may be essential in times of stress in the financial markets. Suppose, for example that a firm has a position in a securities market that is hedged by a position in a commodity market, so that payments that the firm is obligated to make with respect to the securities position will be covered by the receipt of funds from the commodity position. Depending upon the settlement cycles of the different markets, it is possible that the firm could find itself in a position where it is obligated to make the payment with respect to the securities position before it receives the matching funds from the commodity position. If cross-margining arrangements have not been developed between the two markets, the firm may need to borrow funds temporarily to make the earlier payment. The Section 9-115 rules would facilitate the use of positions in one market as collateral for loans needed to cover obligations in the other market.

9. **Relation to other law.** Section 1-103 provides that "unless displaced by particular provisions of this Act, the principles of law and equity . . . shall supplement its provisions." There may be circumstances in which a secured party's action in acquiring a security interest that has priority under this section constitutes conduct that is wrongful under other law. Though the possibility of such resort to other law may provide an appropriate "escape valve" for cases of egregious conduct, care must be taken to ensure that this does not impair the certainty and predictability of the priority rules. Whether a court may appropriately look to other law to impose liability upon or estop a party from asserting its Article 9 priority depends on an assessment of the party's conduct under the standards established by such other law as well as a determination of whether the particular application of such other law is displaced by the UCC.

Some circumstances in which other law is clearly displaced by the UCC rules are readily identifiable. Common law "first in time, first in right" principles, or correlative tort liability rules such as common law conversion principles under which a purchaser may incur liability to a party with a prior property interest without regard to awareness of that claim, are necessarily displaced by the priority rules set out in this section since these rules determine the relative ranking of security interests in investment property. So too, Article 8 provides protections against adverse claims to certain purchasers of interests in investment property. In circumstances where a secured party not only has priority under Section 9-115, but also qualifies for protection against adverse claims under Section 8-303, 8-502, or 8-510, resort to other law would be precluded.

In determining whether it is appropriate in a particular case to look to other law, account must also be taken of the policies that underlie the commercial law rules on securities markets and security interests in securities. A principal objective of the revision of Article 8 and corresponding provisions of Article 9 is to ensure that secured financing transactions can be implemented on a simple, timely, and certain basis. One of the circumstances that led to the revision was the concern that uncertainty in the application of the rules on secured transactions involving securities and other financial assets could contribute to systemic risk by impairing the ability of financial institutions to provide liquidity to the markets in times of stress. The control priority rule is designed to provide a clear and certain rule to ensure that lenders who have taken the necessary steps to establish control do not face a risk of subordination to other lenders who have not done so.

The control priority rule does not turn on an inquiry into the state of a party's awareness of potential conflicting claims because a rule under which a party's rights depended on that sort of after the fact inquiry could introduce an unacceptable measure of uncertainty. If an inquiry into awareness could provide a complete and satisfactory resolution of the problem in all cases, the priority rule of this section would have incorporated that test. The fact that it does not necessarily means that resort to other law based solely on that factor is precluded, though the question whether a control secured party induced or encouraged its financing arrangement with actual knowledge that the debtor would be violating the rights of another secured party may, in some circumstances, appropriately be treated as a factor in determining whether the control party's action is the kind of egregious conduct for which resort to other law is appropriate.

Definitional Cross References:

"Broker"	Section 8-102(a)(3).
"Certificated security"	Section 8-102(a)(4).
"Collateral"	Section 9-105(1)(c).
"Control"	Section 8-106.
"Debtor"	Section 9-105(1)(d).
"Delivery"	Section 8-301.

"Entitlement holder"	Section 8-102(a)(7).
"Secured party"	Section 9-105(1)(m).
"Securities account"	Section 8-501.
"Securities intermediary"	Section 8-102(a)(14).
"Security"	Section 8-102(a)(15).
"Security agreement"	Section 9-105(1)(l).
"Security certificate"	Section 8-102(a)(16).
"Security entitlement"	Section 8-102(a)(17).
"Security interest"	Section 1-201(37).
"Uncertificated security"	Section 8-102(a)(18).

Editor's Note. — Session Laws 1997-181, s. 29(b), made this section effective October 1, 1997, and provides that it does not affect actions or proceedings commenced before that date.

Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

§ 25-9-116. Security interest arising in purchase or delivery of financial asset.

(1) If a person buys a financial asset through a securities intermediary in a transaction in which the buyer is obligated to pay the purchase price to the securities intermediary at the time of the purchase, and the securities intermediary credits the financial asset to the buyer's securities account before the buyer pays the securities intermediary, the securities intermediary has a security interest in the buyer's security entitlement securing the buyer's obligation to pay. A security agreement is not required for attachment or enforceability of the security interest, and the security interest is automatically perfected.

(2) If a certificated security or other financial asset represented by a writing which in the ordinary course of business is transferred by delivery with any necessary indorsement or assignment is delivered pursuant to an agreement between persons in the business of dealing with such securities or financial assets, and the agreement calls for delivery versus payment, the person delivering the certificate or other financial asset has a security interest in the certificated security or other financial asset securing the seller's right to receive payment. A security agreement is not required for attachment or enforceability of the security interest, and the security interest is automatically perfected. (1997-181, s. 6.)

OFFICIAL COMMENT

1. This section establishes two special rules concerning security interests in investment property in order to provide certainty in the securities settlement system.

2. Depending upon a securities inter-

mediary's arrangements with its entitlement holders, the securities intermediary may treat the entitlement holder as entitled to the securities in question before the entitlement holder has actually made payment for them. For example, many brokers permit retail customers to pay for securities by check. The broker may not receive final payment of the check until several days after the broker has credited the customer's securities account for the securities. Thus, the customer will have acquired a security entitlement prior to payment. Subsection (1) provides that in such circumstances the securities intermediary has a security interest in the entitlement holder's security entitlement as security for the payment obligation. This is a codification and adaptation to the indirect holding system of the so-called "broker's lien," which has long been recognized in existing law. See Restatement of Security section 12. An intermediary who has a security interest under this section will have control by virtue of section 8-106(e). The security interest has priority over conflicting security interests granted by the entitlement holder, under section 9-115(5)(a) and (c).

3. Subsection (2) specifies the rights of persons who deliver certificated securities or other financial assets in physical form, such as money market instruments, if the agreed payment is not received. In the typical arrangement for settlement of physical securities, the seller's securities custodian will deliver the physical certificates to the buyer's securities custodian and receive a time-stamped delivery receipt. The buyer's securities custodian will examine the certificate to ensure that it is in good order, and that the delivery matches a trade in which the buyer has instructed the seller to deliver to that custodian. If all is in order, the receiving custodian will settle with the delivering custodian through whatever funds settlement system has been agreed upon or is used by custom and usage in that market. The understanding of the trade, however, is that the delivery is conditioned upon payment, so that if payment is not made for any reason, the security will be returned to the deliverer. Subsection (2) is intended to clarify the rights of persons making deliveries in such circumstances. It specifies that the person making delivery has a security interest in the securities or other financial assets, securing the right to receive payment. No security agreement is required for attachment, and no filing or other action is required for perfection.

Definitional Cross References

"Certificated security" Section 8-102(a)(4).
"Financial asset" Section 8-102(a)(9).
"Securities account" Section 8-501.
"Securities intermediary" Section 8-102(a)(14).
"Security agreement" Section 9-105(1)(l).
"Security entitlement" Section 8-102(a)(17).
"Security interest" Section 1-201(37).

Editor's Note. — Session Laws 1997-181, s. 29(b), made this section effective October 1, 1997, and provides that it does not affect actions or proceedings commenced before that date.

Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

PART 2.

VALIDITY OF SECURITY AGREEMENT AND RIGHTS OF PARTIES THERETO.

§ 25-9-203. Attachment and enforceability of security interest; proceeds; formal requisites.

(1) Subject to the provisions of G.S. 25-4-208 on the security interest of a collecting bank, G.S. 25-9-115 and G.S. 25-9-116 on security interests in investment property, and G.S. 25-9-113 on a security interest arising under the article on sales, a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless

(a) the collateral is in the possession of the secured party pursuant to agreement, the collateral is investment property and the secured party has control pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned; and

(b) value has been given; and

(c) the debtor has rights in the collateral.

(2) A security interest attaches when it becomes enforceable against the debtor with respect to the collateral. Attachment occurs as soon as all of the events specified in subsection (1) have taken place unless explicit agreement postpones the time of attaching.

(3) Unless otherwise agreed a security agreement gives the secured party the rights to proceeds provided by G.S. 25-9-306.

(4) A transaction, although subject to this article, is also subject to the North Carolina Consumer Finance Act (being G.S. 53-164 through 53-191), G.S. 24-1 and 24-2, the Pawnbrokers Modernization Act of 1989 (being Chapter 91A of the General Statutes), the Retail Installment Sales Act (being Chapter 25A of the North Carolina General Statutes), and in the case of conflict between the provisions of this article and any such statute, the provisions of such statute control. Failure to comply with any applicable statute has only the effect which is specified therein. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, s. 2; c. 196, s. 2; 1955, c. 386, s. 1; c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, ss. 8(h), 10(a); 1997-181, s. 7.)

Editor's Note. — Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

Effect of Amendments. — The 1997 amendment, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, substituted "G.S. 25-9-115 and G.S. 25-9-116 on security interests in investment property" for "G.S. 25-8-321 on security interests in securities" in the introductory language of subsection (1); and inserted "the collateral is investment property and the secured party has control pursuant to agreement" in subdivision (1)(a).

CASE NOTES

A financing statement serves as notice to third parties that a security interest may be held in the property. Dowell v. D.R. Kincaid Chair Co., 125 N.C. App. 557, 481 S.E.2d 670 (1997).

Purchase contract, read together with the financing statement, did not constitute a security agreement as the financing statement did no more than meet the requirements of § 25-9-402. Crocker v. Delta Group, Inc., 125 N.C. App. 583, 481 S.E.2d 694 (1997).

Security Agreement Established Limits of Security Interest. — Where security agreement was unambiguous and did not include after-acquired collateral, the security agreement, not the financing statement, established the scope or limits of the security interest. Dowell v. D.R. Kincaid Chair Co., 125 N.C. App. 557, 481 S.E.2d 670 (1997).

PART 3.

RIGHTS OF THIRD PARTIES; PERFECTED AND UNPERFECTED SECURITY INTERESTS; RULES OF PRIORITY.

§ 25-9-301. Persons who take priority over unperfected security interests; rights of "lien creditor."

(1) Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of

(a) persons entitled to priority under G.S. 25-9-312;

(b) a person who becomes a lien creditor before the security interest is perfected;

(c) in the case of goods, instruments, documents, and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business or is a buyer of farm products in ordinary course of business, to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected;

(d) in the case of accounts, general intangibles, and investment property, a person who is not a secured party and who is a transferee to the extent that he gives value without knowledge of the security interest and before it is perfected.

(2) If the secured party files with respect to a purchase money security interest before or within 20 days after the debtor receives possession of the collateral, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

(3) A "lien creditor" means a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for benefit of creditors from the time of assignment, and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment.

(4) A person who becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secures advances made before he becomes a lien creditor or within 45 days thereafter or made without knowledge of the lien or pursuant to a commitment entered into without knowledge of the lien. (1945, c. 182, s. 4; c. 196, s. 4; 1955, c. 386, s. 2; 1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 1979, c. 404, s. 1; 1997-181, s. 8.)

Editor's Note. — Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

Effect of Amendments. — The 1997 amendment, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, substituted "accounts, general intangibles, and investment property" for "accounts and general intangibles" in subdivision (1)(d).

CASE NOTES

Judicial Lien Creditor's Rights Subordinate to Perfected Security Interest. — As a hypothetical judicial lien creditor, Trustee's rights were subordinate to a properly perfected security interest. In re White, 183 Bankr. 713 (Bankr. M.D.N.C. 1995).

§ 25-9-302. When filing is required to perfect security interests; security interests to which filing provisions of this article do not apply.

(1) A financing statement must be filed to perfect all security interests except the following:

(a) a security interest in collateral in possession of the secured party under G.S. 25-9-305;

(b) a security interest temporarily perfected in instruments, certificated securities, or documents without delivery under G.S. 25-9-304 or in proceeds for a 10-day period under G.S. 25-9-306;

(c) a security interest created by an assignment of a beneficial interest in a trust or a decedent's estate;

(d) a purchase money security interest in consumer goods; but compliance with G.S. 20-58 et seq. is required for a motor vehicle required to be registered; and fixture filing is required for priority over conflicting interests in fixtures to the extent provided in G.S. 25-9-313;

(e) an assignment of accounts which does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts of the assignor;

(f) a security interest of a collecting bank (G.S. 25-4-208) or arising under the article on sales (see G.S. 25-9-113) or covered in subsection (3) of this section;

(g) an assignment for the benefit of all the creditors of the transferor, and subsequent transfers by the assignee thereunder;

(h) a security interest in investment property which is perfected without filing under G.S. 25-9-115 or G.S. 25-9-116.

(2) If a secured party assigns a perfected security interest, no filing under this article is required in order to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

(3) The filing of a financing statement otherwise required by this article is not necessary or effective to perfect a security interest in property subject to

(a) a statute or treaty of the United States which provides for a national or international registration or a national or international certificate of title or which specifies a place of filing different from that specified in this article for filing of the security interest; or

(b) the following statute of this State: G.S. 20-58 et seq. as to any personal property required to be registered pursuant to Chapter 20 of the General Statutes; but during any period in which collateral is inventory held for sale by a person who is in the business of selling goods of that kind, the filing provisions of this article (part 4) apply to a security interest in that collateral created by him as debtor; or

(c) a certificate of title statute of another jurisdiction under the law of which indication of a security interest on the certificate is required as a condition of perfection (subsection (2) of G.S. 25-9-103).

(4) Compliance with a statute or treaty described in subsection (3) is equivalent to the filing of a financing statement under this article, and a security interest in property subject to the statute or treaty can be perfected only by compliance therewith except as provided in G.S. 25-9-103 on multiple-state transactions. Duration and renewal of perfection of a security interest perfected by compliance with the statute or treaty are governed by the provisions of the statute or treaty; in other respects the security interest is subject to this article.

(5) The filing provisions of this article do not apply to a security interest in property of any description or any interest therein created by a deed of trust or mortgage made by a public utility as defined in G.S. 62-3(23), or by any electric or telephone membership corporation domesticated or incorporated in North Carolina, but the deed of trust or mortgage shall be registered in the county or counties in which such deed of trust or mortgage is required by G.S. 47-20 to be registered, and all such instruments, including those creating security interests in personal property, shall be recorded in the real property records and indexed in the real property indexes.

(6) The filing provisions of this article do not apply to any security interest created in connection with the issuance of any bond, note or

other evidence of indebtedness for borrowed money by this State or any political subdivision or agency thereof. (1866-7, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, s. 3; c. 196, s. 2; 1955, c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1977, c. 103; 1989 (Reg. Sess., 1990), c. 1024, s. 8(i); 1997-181, s. 9.)

Editor's Note. — Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

Effect of Amendments. — The 1997 amendment, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, inserted "certificated securities" in subdivision (1)(b); deleted "or in securities (G.S. 25-8-321)" preceding "or arising" in subdivision (1)(f); and added subdivision (1)(h) and made a related change.

CASE NOTES

Article Inapplicable to Motor Vehicles, etc. —

§ 25-9-303. When security interest is perfected; continuity of perfection.

(1) A security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken. Such steps are specified in G.S. 25-9-115, 25-9-302, 25-9-304, 25-9-305 and 25-9-306. If such steps are taken before the security interest attaches, it is perfected at the time it attaches.

(2) If a security interest is originally perfected in any way permitted under this article and is subsequently perfected in some other way under this article, without an intermediate period when it was unperfected, the security interest shall be deemed to be perfected continuously for the purposes of this article. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 1997-456, s. 6.)

Effect of Amendments. — The 1997 amendment, effective August 29, 1997, inserted "25-9-115" in subsection (1).

§ 25-9-304. Perfection of security interest in instruments, documents, and goods covered by documents; perfection by permissive filing; temporary perfection without filing or transfer of possession.

(1) A security interest in chattel paper or negotiable documents may be perfected by filing. A security interest in money or instruments (other than instruments which constitute part of chattel paper) can be perfected only by the secured party's taking possession, except as provided in subsections (4) and (5) of this section and subsections (2) and (3) of G.S. 25-9-306 on proceeds.

(2) During the period that goods are in the possession of the issuer of a negotiable document therefor, a security interest in the goods is perfected by perfecting a security interest in the document, and any security interest in the goods otherwise perfected during such period is subject thereto.

(3) A security interest in goods in the possession of a bailee other than one who has issued a negotiable document therefor is perfected by issuance of a document in the name of the secured party or by the bailee's receipt of notification of the secured party's interest or by filing as to the goods.

(4) A security interest in instruments, certificated securities, or negotiable documents is perfected without filing or the taking of possession for a period of 21 days from the time it attaches to the extent that it arises for new value given under a written security agreement.

(5) A security interest remains perfected for a period of 21 days without filing where a secured party having a perfected security interest in an instrument, a certificated security, a negotiable document or goods in possession of a bailee other than one who has issued a negotiable document therefor

(a) makes available to the debtor the goods or documents representing the goods for the purpose of ultimate sale or exchange or for the purpose of loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with them in a manner preliminary to their sale or exchange, but priority between conflicting security interests in the goods is subject to subsection (3) of G.S. 25-9-312; or

(b) delivers the instrument or certificated security to the debtor for the purpose of ultimate sale or exchange or of presentation, collection, renewal or registration of transfer.

(6) After the 21-day period in subsections (4) and (5) perfection depends upon compliance with applicable provisions of this article. (1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(j)-(l); 1997-181, s. 10.)

Editor's Note. — Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

Effect of Amendments. — The 1997 amendment, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, deleted "certificated securities or" preceding "instruments" in subsection (1); substituted "instruments, certificated securities" for "instruments (other than certificated securities)" in subsection (4); substituted "instrument, a certificated security" for "instrument (other than a certificated security)" in subsection (5); and inserted "or certificated security" in subdivision (5)(b).

§ 25-9-305. When possession by secured party perfects security interest without filing.

A security interest in letters of credit and advices of credit (subsection (2)(a) of G.S. 25-5-116), goods, instruments, money, negotiable documents or chattel paper may be perfected by the secured party's taking possession of the collateral. If such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest. A security interest is perfected by possession from the time possession is taken without relation back and continues only so long as possession is retained, unless otherwise specified in this article. The security interest may be otherwise perfected as provided in this article before or after the period of possession by the secured party. (1965, c. 700, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(k); 1997-181, s. 11.)

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. As under the common law of pledge, no filing is required by this Article to perfect a security interest where the secured party has possession of the collateral. Compare Section 9-302(1)(a). This section permits a security interest to be perfected by transfer of possession only when the collateral is goods, instruments, documents or chattel paper: that is to say, accounts and general intangibles are excluded. As to perfection of security interests in certificated securities by possession, see the general rules on perfection of security interests in investment property in Section 9-115(4) and the special rule in Section 9-115(6) dealing with cases where a secured party takes possession of a security certificate in registered form without obtaining an indorsement. See Section 5-116 for the special case of assignments of letters and advices of credit. A security interest in accounts and general intangibles — property not ordinarily represented by any writing whose delivery operates to transfer the claim — may under this Article be perfected only by filing, and this rule would not be affected by the fact that a security agreement or other writing described the assignment of such collateral as a "pledge". Section 9-302(1)(e) exempts from filing certain assignments of accounts which are out of the ordinary course of financing: such exempted assignments are perfected when they attach under Section 9-303(1); they do not fall within this section.

2. Possession may be by the secured party himself or by an agent on his behalf: it is of course clear, however, that the debtor or a person controlled by him cannot qualify as such an agent for the secured party. See also the last sentence of Section 9-205. Where the collateral (except for goods covered by a negotiable document) is held by a bailee, the time of perfection of the security interest, under the second sentence of the section, is when the bailee receives notification of

the secured party's interest: this rule rejects the common law doctrine that it is necessary for the bailee to attorn to the secured party or acknowledge that he now holds on his behalf.

3. The third sentence of the section rejects the "equitable pledge" theory of relation back, under which the taking possession was deemed to relate back to the date of the original security agreement. The relation back theory has had little vitality since the 1938 revision of the Federal Bankruptcy Act, which introduced in Section 60a provisions designed to make such interests voidable as preferences in bankruptcy proceedings. This section now brings state law into conformity with the overriding federal policy: where a pledge transaction is contemplated, perfection dates only from the time possession is taken, although a security interest may attach, unperfected, before that under the rules stated in Section 9-204. The only exception to this rule is the short twenty-one day period of perfection provided in Section 9-304 (4) and (5) during which a debtor may have possession of specified collateral in which there is a perfected security interest.

Cross References:

Sections 5-116, 9-204, 9-302, 9-303 and 9-304.

Definitional Cross References:

"Chattel paper"	Section 9-105.
"Collateral"	Section 9-105.
"Documents"	Section 9-105.
"Goods"	Section 9-105.
"Instruments"	Section 9-105.
"Receives" notification	Section 1-201.
"Secured party"	Section 9-105.
"Security interest"	Section 1-201.

Editor's Note. — Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

Effect of Amendments. — The 1997 amendment, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, deleted "(other than certificated securities)" following "instruments."

§ 25-9-306. "Proceeds"; secured party's rights on disposition of collateral.

(1) "Proceeds" includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement. Any payments or distributions made with respect to investment property collateral are proceeds. Money, checks, deposit accounts, and the like are "cash proceeds." All other proceeds are "noncash proceeds."

(2) Except where this article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

(3) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected 10 days after receipt of the proceeds by the debtor unless

(a) a filed financing statement covers the original collateral and the proceeds are collateral in which a security interest may be perfected by filing in the office or offices where the financing statement has been filed and, if the proceeds are acquired with cash proceeds, the description of collateral in the financing statement indicates the types of property constituting the proceeds;

(b) a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds;

(b1) the original collateral was investment property and the proceeds are identifiable cash proceeds; or

(c) the security interest in the proceeds is perfected before the expiration of the 10-day period.

Except as provided in this section, a security interest in proceeds can be perfected only by the methods or under the circumstances permitted in this article for original collateral of the same type.

(4) In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest only in the following proceeds:

(a) in identifiable noncash proceeds and in separate deposit accounts containing only proceeds;

(b) in identifiable cash proceeds in the form of money which is neither commingled with other money nor deposited in a deposit account prior to the insolvency proceedings;

(c) in identifiable cash proceeds in the form of checks and the like which are not deposited in a deposit account prior to the insolvency proceedings; and

(d) in all cash and deposit accounts of the debtor in which proceeds have been commingled with other funds, but the perfected security interest under this paragraph (d) is

(i) subject to any right to setoff; and

(ii) limited to an amount not greater than the amount of any cash proceeds received by the debtor within 10 days before the institution of the insolvency proceedings less the sum of (I) the payments to the secured party on account of cash proceeds received by the debtor during such periods and (II) the cash proceeds received by the debtor during such period to which the secured party is entitled under paragraphs (a) through (c) of this subsection (4).

(5) If a sale of goods results in an account or chattel paper which is transferred by the seller to a secured party, and if the goods are returned to or are repossessed by the seller or the secured party, the following rules determine priorities:

(a) If the goods were collateral at the time of sale, for an indebtedness of the seller which is still unpaid, the original security interest attaches again to the goods and continues as a perfected security interest if it was perfected at the time when the goods were sold. If the security interest was originally perfected by a filing which is still effective, nothing further is required to continue the perfected status; in any other case, the secured party must take possession of the returned or repossessed goods or must file.

(b) An unpaid transferee of the chattel paper has a security interest in the goods against the transferor. Such security interest is prior to a security interest asserted under paragraph (a) to the extent that the transferee of the chattel paper was entitled to priority under G.S. 25-9-308.

(c) An unpaid transferee of the account has a security interest in the goods against the transferor. Such security interest is subordinate to a security interest asserted under paragraph (a).

(d) A security interest of an unpaid transferee asserted under paragraph (b) or (c) must be perfected for protection against creditors of the transferor and purchasers of the returned or repossessed goods. (1945, c. 196, s. 8; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1975, c. 862, s. 7; 1997-181, ss. 12, 13.)

Editor's Note. — Subdivisions (3)(b1) and (3)(c) were so designated at the direction of the Revisor of Statutes, the designations in Session Laws 1997-181, s. 13, having been (3)(c) and (3)(d), respectively.

Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

Effect of Amendments. — Session Laws 1997-181, ss. 12 and 13, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, inserted the third sentence of subsection (1); added subdivision (3)(c) and made related changes; and redesignated former subdivision (3)(c) as subdivision (3)(d).

§ 25-9-309. Protection of purchasers of instruments, documents, and securities.

Nothing in this article limits the rights of a holder in due course of a negotiable instrument (G.S. 25-3-302) or a holder to whom a negotiable document of title has been duly negotiated (G.S. 25-7-501) or a protected purchaser of a security (G.S. 25-8-303) and such holders or purchasers take priority over an earlier security interest even though perfected. Filing under this article does not constitute notice of the security interest to such holders or purchasers. (1961, c. 574; 1965, c. 700, s. 1; 1975, c. 862, s. 7; 1989 (Reg. Sess., 1990), c. 1024, s. 8(m), (n); 1997-181, s. 14.)

Editor's Note. — Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

Effect of Amendments. — The 1997 amendment, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, substituted "protected purchaser of a security (G.S. 25-8-303)" for "bona fide purchaser of a security (G.S. 25-8-302)."

§ 25-9-312. Priorities among conflicting security interests in the same collateral.

(1) The rules of priority stated in other sections of this part and in the following sections shall govern when applicable: G.S. 25-4-208 with respect to the security interests of collecting banks in items being collected, accompanying documents and proceeds; G.S. 25-9-103 on security interests related to other jurisdictions; G.S. 25-9-114 on consignments; G.S. 25-9-115 on security interests in investment property.

(2)(a) A perfected security interest in crops for new value given to enable the debtor to purchase agricultural supplies to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise takes priority over any perfected security interest in those crops, even though the person giving new value had knowledge of the earlier security interest. Priority between conflicting security interests in crops for new value given to enable the debtor to purchase agricultural supplies not more than three months before the crops became growing crops is governed by subdivision [subsection] (5) of this section.

(b) Within five days of perfecting a security interest in crops for new value given to enable the debtor to purchase agricultural supplies, the holder of the security interest shall notify in writing by certified mail, addressee only, the holder of the conflicting security interest that the person giving the notice has or expects to acquire a security interest in the crops of the debtor. The notice shall identify the debtor, describe the type of crops, state the year or years in which the crops will be grown, and describe the land where the crops are growing or to be grown.

(c) Creating or perfecting a security interest in crops for new value given to enable the debtor to purchase agricultural supplies shall not operate under any circumstances as a default on, an accelerating event under, or otherwise as a breach of any note or other instrument or agreement of any kind or nature to pay debt, any loan or credit agreement, or any security arrangement of any kind or nature where the collateral is real or personal property.

(d) As used in this subdivision [subsection], "agricultural supplies" includes agricultural seeds as defined in G.S. 106-277.2, soil additives as defined in G.S. 106-50.31, fertilizer materials as defined in G.S. 106-657, liming materials as defined in G.S. 106-92.3, pesticides as defined in G.S.

106-65.24, herbicides as defined in G.S. 143-460, and curing oil and gas.

(3) A perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable cash proceeds received on or before the delivery of the inventory to a buyer if:

(a) The purchase money security interest is perfected at the time the debtor receives possession of the inventory; and

(b) The purchase money secured party gives notification in writing to the holder of the conflicting security interest if the holder had filed a financing statement covering the same types of inventory (i) before the date of the filing made by the purchase money secured party, or (ii) before the beginning of the 21-day period where the purchase money security interest is temporarily perfected without filing or possession (subsection (5) of G.S. 25-9-304); and

(c) The holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and

(d) The notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

(4) A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within 20 days thereafter.

(5) In all cases not governed by other rules stated in this section (including cases of purchase money security interests which do not qualify for the special priorities set forth in subsections (3) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined according to the following rules:

(a) Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection.

(b) So long as conflicting security interests are unperfected, the first to attach has priority.

(6) For the purposes of subsection (5) a date of filing or perfection as to collateral is also a date of filing or perfection as to proceeds.

(7) If future advances are made while a security interest is perfected by filing, the taking of possession, or under G.S. 25-9-115 or G.S. 25-9-116 on investment property, the security interest has the same priority for the purposes of subsection (5) or G.S. 25-9-115(5) with respect to the future advances as it does with respect to the first advance. If a commitment is made before or while the security interest is so perfected, the security interest has the same priority with respect to advances made pursuant thereto. In other cases a perfected security interest has priority from the date the advance is made. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 196, s. 4; 1955, c. 816; 1957, c. 999; 1965, c. 700, s. 1; 1967, c. 24, s. 13; 1975, c. 862, s. 7; 1979, c. 404, s. 2; 1989 (Reg.

Sess., 1990), c. 1024, s. 8(o); 1997-181, ss. 15, 16; 1997-336, s. 1; 1997-456, s. 5.)

Editor's Note. — The bracketed word "subsection" was inserted in subdivisions (2)(a) and (2)(d) at the direction of the Revisor of Statutes.

Session Laws 1997-181, s. 29(a), provides: "If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect."

Effect of Amendments. — Session Laws 1997-181, ss. 15 and 16, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, added "G.S. 25-9-115 on security interests in investment property" in subsection (1); and substituted "G.S. 25-9-115 or G.S. 25-9-116 on investment property" for "G.S. 25-8-321 on securities" in subsection (7).

Session Laws 1997-336, s. 1, effective October 1, 1997, and applicable to security interests perfected on or after that date, but not affecting any contract entered into or security interest or lien perfected prior to that date, rewrote subsection (2) and made stylistic changes in subsection (3).

Session Laws 1997-456, s. 5, effective August 29, 1997, inserted "or G.S. 25-9-115(5)" following "subsection (5)" in subsection (7).

PART 4.

FILING.

§ 25-9-402. Formal requisites of financing statement; amendments; mortgage as financing statement.

CASE NOTES

The purpose of a financing statement is to provide notice to third parties of the debtor-creditor relationship, and where the correct debtor was listed in the debtor box accompanied by the names of the individual partners, this identification met the statute's requirements. Mountain Farm Credit Serv. v. Purina Mills, Inc., 119 N.C. App. 508, 459 S.E.2d 75 (1995).

A financing statement which does no more than meet the requirements, etc. —

Purchase contract read together with the financing statement, did not constitute a security agreement as the financing statement did no more than meet the requirements of this section. Crocker v. Delta Group, Inc., 125 N.C. App. 583, 481 S.E.2d 694 (1997).

§ 25-9-403. What constitutes filing; duration of filing; effect of lapsed filing; duties of filing officer.

(1) Presentation for filing of a financing statement and tender of the filing fee or acceptance of the statement by the filing officer constitutes filing under this article.

(2) Except as provided in subsection (6), or in Article 12 of Chapter 44, a filed financing statement is effective for a period of five years from the date of filing. The effectiveness of a filed financing statement lapses on the expiration of the five-year period unless a continuation statement is filed prior to the lapse. If a security interest perfected by filing exists at the time insolvency proceedings are commenced by or against the debtor, the security interest remains perfected until termination of the insolvency proceedings and thereafter for a period of 60 days or until expiration of the five-year period, whichever occurs later. Upon lapse the security interest becomes unperfected, unless it is perfected without filing. If the security interest becomes unperfected upon lapse, it is deemed to have been unperfected as against a person who became a purchaser or lien creditor before lapse.

(3) A continuation statement may be filed by the secured party within six months prior to the expiration of the five-year period specified in subsection (2). Any such continuation statement must be signed by the secured party, identify the original statement by file number and also by the most current file number if any continuation was filed and state that the original statement is still effective. A continuation statement signed by a person other than the secured party of record must be accompanied by a separate written statement of assignment signed by the secured party of record and complying with subsection (2) of G.S. 25-9-405, including payment of the required fee. Upon timely filing of the continuation statement, the effectiveness of the original statement is continued for five years after the last date to which the filing was effective whereupon it lapses in the same manner as provided in subsection (2) unless another continuation statement is filed prior to such lapse. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the original statement. Unless a statute on disposition of public records provides otherwise, the filing officer may remove a lapsed statement from the files and destroy it immediately if he has retained a microfilm or other photographic record, or in other cases after one year after the lapse. The filing officer shall so arrange matters by physical annexation of financing statements to continuation statements or other related filings, or by other means, that if he physically destroys the financing statements of a period more than five years past, those which have been continued by a continuation statement or which are still effective under subsection (6) shall be retained. Any continuation statement which is not filed in accordance with the requirements set forth herein and during the stated time periods set forth above shall be invalid.

(4) A filing officer shall mark each statement with a file number and with the date and hour of filing and shall hold the statement or a microfilm or other photographic copy thereof for public inspection. In addition the filing officer shall index the statement according to the name of the debtor and shall note in the index the file number given in the statement.

(5) The uniform fee for filing and indexing and for stamping a copy furnished by the secured party to show the date and place of filing for an original financing statement or for a continuation statement is fifteen dollars ($15.00).

(6) A real estate mortgage which is effective as a fixture filing under subsection (6) of G.S. 25-9-402 remains effective as a fixture filing until the mortgage is redeemed or satisfied of record or its effectiveness otherwise terminates as to the real estate.

(7) When a financing statement covers timber to be cut or covers minerals or the like (including oil and gas) or accounts subject to subsection (5) of G.S. 25-9-103, or is filed as a fixture filing, the filing officer, in addition to complying with subsection (4) of this section, shall:

(a) index the statements in the Uniform Commercial Code index to financing statements so as to reflect the name of any record owner given in the statement. When the debtor is not the record owner, the filing officer shall enter the name of the record owner in the place designated for entry of the name of the debtor and shall stamp or print conspicuously beneath the surname of the record owner the legend "RECORD OWNER" and shall note therein the file number of the financing statement. When the debtor is also the record owner, the filing officer shall make one index entry in the name of the debtor and shall stamp or print conspicuously beneath his surname the legend, "RECORD OWNER." The filing officer shall also:

(b) index the statements in the real estate indexes under the names of the debtor and any owner of record shown on the financing statement in the same fashion as if they were the mortgagors in a mortgage of the real estate described, and, to the extent that the law of this State provides for indexing of mortgages under the name of the mortgagee, under the name of the secured party as if he were the mortgagee thereunder, or where indexing is by description in the same fashion as if the financing statement were a mortgage of the real estate described. (1866-7, c. 1, s. 1; 1872-3, c. 133, s. 1; Code, s. 1799; 1893, c. 9; Rev., s. 2052; C.S., s. 2480; 1925, c. 302, s. 1; 1927, c. 22; 1935, c. 205; 1945, c. 182, ss. 2, 4; c. 196, s. 2; 1955, c. 386, ss. 1, 2; c. 816; 1957, cc. 564, 999; 1961, c. 574; 1965, c. 700, s. 1; 1967, c. 562, s. 1; 1969, c. 1115, s. 1; 1971, c. 1170; 1973, c. 1316, s. 1; 1975, c. 862, s. 7; 1977, cc. 156, 295; 1983, c. 713, s. 23; 1987, c. 792, s. 6; 1989, c. 523, s. 4; 1991, c. 164, s. 1; 1997-456, s. 55.3; 1997-475, s. 5.4.)

Editor's Note. — Session Laws 1997-475, s. 5.8, as amended by Session Laws 1997-456, s. 55.3, provides in part: "Sections 5.4 through 5.7 of this act become effective November 1, 1997."

Effect of Amendments. — The 1997 amendment, effective November 1, 1997, substituted "fifteen dollars ($15.00)" for "eight dollars ($8.00)" in subsection (5).

§ 25-9-405. Assignment of security interest; duties of filing officer; fees.

(1) A financing statement may disclose an assignment of a security interest in the collateral described in the financing statement by indication in the financing statement of the name and address of the assignee or by an assignment itself or a copy thereof on the face or back of the statement. On presentation to the filing officer of such a financing statement the filing officer shall mark the same as provided in G.S. 25-9-403(4). The uniform fee for filing, indexing, and furnishing filing data for a financing statement so indicating an assignment is fifteen dollars ($15.00).

(2) A secured party may assign of record all or part of his rights under a financing statement by the filing in the place where the original financing statement was filed of a separate written statement of assignment signed by the secured party of record and setting forth the name of the secured party of record and the debtor, the file number and also the most current file number if it has been continued and the date of filing of the financing statement and the name and address of the assignee and containing a description of the collateral assigned. A copy of the assignment is sufficient as a separate statement if it complies with the preceding sentence. On presentation to the filing officer of such a separate statement, the filing officer shall mark such separate statement with the date and hour of the filing. He shall note the assignment on the Uniform Commercial Code index of the financing statement, and in the case of a fixture filing, or a filing covering timber to be cut, or covering minerals or the like (including oil and gas) or accounts subject to subsection (5) of G.S. 25-9-103, he shall index in the real estate index the assignment under the name of the assignor as grantor and, to the extent that the law of this State provides for indexing the assignment of a mortgage under the name of the assignee, he shall index the assignment of the financing statement under the name of the assignee. The uniform fee for filing, indexing, and furnishing filing data about such a separate statement of assignment is fifteen dollars ($15.00). Notwithstanding the provisions of this subsection, an assignment of record of a security interest in a fixture contained in a mortgage effective as a fixture filing (subsection (6) of G.S. 25-9-402) may be made only by an assignment of the mortgage in the manner provided by the law of the State other than this Chapter.

(3) After the disclosure or filing of an assignment under this section, the assignee is the secured party of record. (1965, c. 700, s. 1; 1967, c. 24, s. 23; 1969, c. 1115, s. 1; 1973, c. 1316, ss. 4, 5; 1975, c. 862, s. 7; 1983, c. 713, ss. 24, 25; 1987, c. 792, ss. 7, 8; 1989, c. 523, s. 6; 1997-456, s. 55.3; 1997-475, s. 5.5.)

Editor's Note. — Session Laws 1997-475, s. 5.8, as amended by Session Laws 1997-456, s. 55.3, provides in part: "Sections 5.4 through 5.7 of this act become effective November 1, 1997."

Effect of Amendments. — The 1997 amendment, effective November 1, 1997, in the last sentence of subsection (1) and the next to last sentence of subsection 2, substituted "fifteen dollars ($15.00)" for "eight dollars ($8.00)".

§ 25-9-406. Release of collateral; duties of filing officer; fees.

A secured party of record may, by his signed statement, release all or a part of any collateral described in a filed financing statement. The statement of release is sufficient if it contains a description of the collateral being released, the name and address of the debtor, the name and address of the secured party, and the file number of the financing statement. A statement of release signed by a person other than the secured party of record must be accompanied by a separate written statement of assignment signed by the secured party of record and complying with subsection (2) of G.S. 25-9-405, including payment of the required fee. Upon presentation of such a statement of release to the filing officer he shall mark the statement with the hour and date of filing and shall note the same upon the margin of the index of the filing of the financing statement. The uniform fee for filing and noting such a statement of release is fifteen dollars ($15.00). (1965, c. 700, s. 1; 1967, c. 24, s. 25; 1969, c. 1115, s. 1; 1973, c. 1316, s. 6; 1975, c. 862, s. 7; 1983, c. 713, s. 26; 1987, c. 792, s. 9; 1997-456, s. 55.3; 1997-475, s. 5.6.)

Editor's Note. — Session Laws 1997-475, s. 5.8, as amended by Session Laws 1997-456, s. 55.3, provides in part: "Sections 5.4 through 5.7 of this act become effective November 1, 1997."

Effect of Amendments. — The 1997 amendment, effective November 1, 1997, in the last sentence substituted "fifteen dollars ($15.00)" for "eight dollars ($8.00)".

§ 25-9-407. Information from filing officer.

(1) If the person filing any financing statement, termination statement, statement of assignment or statement of release furnishes the filing officer a copy thereof, the filing officer shall upon request note upon the copy the file number and date and hour of the filing of the original and deliver or send the copy to such person.

(2) Upon request of any person, the filing officer shall issue his certificate for which he shall not be liable showing whether there is on file, on the date and hour stated therein, any presently effective financing statement naming a particular debtor and any statement of assignment thereof and if there is, giving the date and hour of filing of each such statement and the names and addresses of each secured party therein. The uniform fee for such a certificate shall be fifteen dollars ($15.00). Where the Uniform Commercial Code index has been automated, the filing officer shall issue a computer printout of the index entries for a particular debtor for a fee of fifteen dollars ($15.00). Upon request the filing officer shall furnish a copy of any filed financing statement or statement of assignment for a uniform fee of one dollar ($1.00) per page. (1965, c. 700, s. 1; 1967, c. 562, s. 1; 1973, c. 1316, s. 7; 1975, c. 862, s. 7; 1983, c. 713, ss. 27, 28; 1987, c. 792, s. 10; 1997-456, s. 55.3; 1997-475, s. 5.7.)

Editor's Note. — Session Laws 1997-475, s. 5.8, as amended by Session Laws 1997-456, s. 55.3, provides in part: "Sections 5.4 through 5.7 of this act become effective November 1, 1997."

Effect of Amendments. — The 1997 amendment, effective November 1, 1997, substituted "fifteen dollars ($15.00)" for "eight dollars ($8.00)" twice in subsection (2).

PART 5.

DEFAULT.

§ 25-9-502. Collection rights of secured party.

CASE NOTES

Cited in Roberts v. First-Citizens Bank & Trust Co., 124 N.C. App. 713, 478 S.E.2d 809 (1996).

§ 25-9-504. Secured party's right to dispose of collateral after default; effect of disposition.

CASE NOTES

Editor's Note. *— The citation to the case of Parks Chevrolet, Inc. v. Watkins, annotated under the catchline "Evidence as to Commercial Reasonableness of Resale Held Insufficient" in the main volume, should read "74 N.C. App. 719, 329 S.E.2d 728 (1985)."*

Failure to Conduct Commercially Reasonable Sale Not Absolute Bar to Deficiency Judgment. — A creditor's failure to conduct the sale in a commercially reasonable manner or to give the required notice of the sale is not an absolute bar to obtaining a deficiency judgment. NationsBank v. American Doubloon Corp., 125 N.C. App. 494, 481 S.E.2d 387 (1997).

The failure to give notice and/or to dispose of collateral in a commercially reasonable manner results in: (1) a presumption that the collateral was worth at least the amount of the debt; and (2) the amount that could have reasonably been obtained from a commercially reasonable sale of the collateral being credited to the debt. NationsBank v. American Doubloon Corp., 125 N.C. App. 494, 481 S.E.2d 387 (1997).

Burden on Creditor to Prove Commercial Reasonableness. — A creditor, when suing for deficiency judgment, bears the burden of proving that the disposition of the collateral was conducted in a commercially reasonable manner- i.e., reasonable notice and commercially reasonable disposition. NationsBank v. American Doubloon Corp., 125 N.C. App. 494, 481 S.E.2d 387 (1997).

Commercial Reasonableness Is Jury Question. —

Commercial reasonableness is a jury question and does not readily lend itself to summary judgment, as reasonable minds may differ over what is commercially reasonable. NationsBank v. American Doubloon Corp., 125 N.C. App. 494, 481 S.E.2d 387 (1997).

A commercially reasonable sale under this section is not an absolute bar to successor liability. G.P. Publications, Inc. v. Quebecor Printing - St. Paul, Inc., 125 N.C. App. 424, 481 S.E.2d 674 (1997).

Notice of Collection. — The court found that notice is required under subsection (3) to debtors who provide instruments as collateral before the secured party collects under those instruments upon default. Roberts v. First-Citizens Bank & Trust Co., 124 N.C. App. 713, 478 S.E.2d 809 (1996).

Cited in G.P. Publications, Inc. v. Quebecor Printing - St. Paul, Inc., 125 N.C. App. 424, 481 S.E.2d 674 (1997).

§ 25-9-505. Compulsory disposition of collateral; acceptance of the collateral as discharge of obligation.

CASE NOTES

Not Applicable to Instrument Intended to Be Cashed in. — Subdivision (2) does not apply where the collateral involved is an instrument which the secured party intends to cash in. Roberts v. First-Citizens Bank & Trust Co., 124 N.C. App. 713, 478 S.E.2d 809 (1996).

The failure to give notice and/or to dispose of collateral in a commercially reasonable manner results in: (1) a presumption that the collateral was worth at least the amount of the debt; and (2) the amount that could have reasonably been obtained from a commercially reasonable sale of the collateral being credited to the debt. NationsBank v. American Doubloon Corp., 125 N.C. App. 494, 481 S.E.2d 387 (1997).

§ 25-9-506. Debtor's right to redeem collateral.

CASE NOTES

Public Policy. — The public policy of the State of North Carolina favors allowing debtors to redeem their property pledged as collateral, if possible, in order to protect their interest. Roberts v. First-Citizens Bank & Trust Co., 124 N.C. App. 713, 478 S.E.2d 809 (1996).

ARTICLE 10.

Effective Date and Repealer.

§ 25-10-102. Specific repealer; provision for transition.

Editor's Note. — Section 39-23 referred to above has been repealed.

§ 25-10-104. Laws not repealed.

(1) The article on documents of title (article 7) does not repeal or modify any laws prescribing the form or contents of documents of title or the services or facilities to be afforded by bailees, or otherwise regulating bailees' businesses in respects not specifically dealt with herein; but the fact that such laws are violated does not affect the status of a document of title which otherwise complies with the definition of a document of title (G.S. 25-1-201).

(2) Repealed by Session Laws 1997-181, s. 21, effective October 1, 1997. (1965, c. 700, s. 7; 1997-181, s. 21.)

Effect of Amendments. — The 1997 amendment, effective October 1, 1997, and not affecting actions or proceedings commenced before that date, repealed subsection (2), concerning nonrepeal of the Uniform Act for the Simplification of Fiduciary Security Transfers, G.S. 32-14 through G.S. 32-24.

Chapter 25A.

Retail Installment Sales Act.

Sec.
25A-2. "Consumer credit sale" defined.
25A-14. Finance charge rates and service charge for revolving charge account contracts.
25A-17. Additional charges for insurance.
25A-27. Application of payments.
25A-32.1. Unearned finance charge credits on prepayment of loans secured by real property and mobile home loans.

§ 25A-1. Scope of act.

CASE NOTES

Class Actions Allowed. — When the General Assembly has wished to prevent class actions to enforce statutory claims for relief, where the relief sought was personal and penal in nature, it has said so expressly and unequivocally. The failure of the General Assembly to expressly prohibit class actions to enforce this statute convinces the Supreme Court that it intended to allow them for such purposes. Crow v. Citicorp Acceptance Co., 319 N.C. 274, 354 S.E.2d 459 (1987).

The court upheld the certification of a class comprising of Chapter 7 debtors whose cases were pending in the bankruptcy courts of the Eastern and Middle Districts of North Carolina on the date of certification who had a Sears revolving charge account governed by this Act that included a balance, as of each debtor's petition date, which represented the credit purchases of at least two items of personal property on which Sears retained security interests. Coggin v. Sears, Roebuck & Co., 155 Bankr. 934 (Bankr. E.D.N.C. 1993).

Pro Rata Application of Payments to Consolidated Purchases Allowed. — The North Carolina Retail Installment Sales Act provides a method for applying payments to consolidated purchases on a pro rata basis. In re Sherman, 126 Bankr. 684 (Bankr. E.D.N.C. 1987).

Cited in Addison v. Britt, 83 N.C. App. 418, 350 S.E.2d 158 (1986); Westminster Co. v. Union Mut. Stock Life Ins. Co. of Am., 95 N.C. App. 117, 381 S.E.2d 857 (1989).

§ 25A-2. "Consumer credit sale" defined.

(a) Except as provided in subsection (c) of this section, a "consumer credit sale" is a sale of goods or services in which

(1) The seller is one who in the ordinary course of business regularly extends or arranges for the extension of consumer credit, or offers to extend or arrange for the extension of such credit,

(2) The buyer is a natural person,

(3) The goods or services are purchased primarily for a personal, family, household or agricultural purpose,

(4) Either the debt representing the price of the goods or services is payable in installments or a finance charge is imposed, and

(5) The amount financed does not exceed twenty-five thousand dollars ($25,000) or, in the case of a debt secured by real property or a manufactured home as defined in G.S. 143-145(7), regardless of the amount financed.

(b) "Sale" includes but is not limited to any contract in the form of a bailment or lease if the bailee or lessee contracts to pay as compensation for use a sum substantially equivalent to or in excess of the aggregate value of the goods and services involved, and it is agreed that the bailee or lessee will become, or for no other or for a nominal consideration, has the option to become, the owner of the goods and services upon full compliance with his obligations under such contract.

The term also includes a contract in the form of a terminable bailment or lease of goods or services in which the bailee or lessee can renew the bailment or lease contract periodically by making the payment or payments specified in the contract if:

(1) The contract obligates the bailor or lessor to transfer ownership of the property to the bailee or lessee for no other or a nominal consideration (no more than ten percent (10%) of the cash price of the property at the time the bailor or lessor initially enters into the contract with the bailee or lessee) upon the making of a specified number of payments by the bailee or lessee; and

(2) The dollar total of the specified number of payments necessary to exercise the purchase option is more than ten percent (10%) in excess of the aggregate value of the property and services involved. For the purposes of this subsection, the value of goods shall be the average cash retail value of the goods. The value of services shall be the average retail value, if any, of such services, as determined by substantial cash sales of such services. If a contract is found to be a sale under this subsection, these values shall be used to determine the amount financed for purposes of G.S. 25A-15.

(c) A sale in which the seller allows the buyer to purchase goods or services pursuant to a credit card issued by someone other than a seller that is engaged in part or entirely in the business of selling goods or services or similar arrangement is not a consumer credit sale. A sale in which the seller allows the buyer to purchase goods or services pursuant to a credit card issued by the seller, a subsidiary or a parent corporation of the seller, a principal supplier of the seller or any corporation having shareholders in common with the seller holding over twenty-five percent (25%) of the voting stock in each corporation is a consumer credit sale within the terms of this Chapter.

(d) For the purposes of this Chapter, a consumer credit sale shall be deemed to have been made in this State, and therefore subject to the provisions of this Chapter, if the seller offers or agrees in this State to sell to a buyer who is a resident of this State, or if such buyer accepts or makes the offer in this State to buy, regardless of the situs of the contract as specified therein.

Any solicitation or communication to sell, oral or written, originating outside of this State, but forwarded to and received in this State by a buyer who is a resident of this State, shall be deemed to be an offer or agreement to sell in this State.

Any solicitation or communication to buy, oral or written, originating within this State, from a buyer who is a resident of this State, but forwarded to and received by a retail seller outside of this State, shall be deemed to be an acceptance or offer to buy in this State.

(e) If an advertisement for a terminable bailment or lease defined as a sale in subsection (b) above states the amount of any payment, the advertisement must also clearly and conspicuously state the following items, as applicable:

(1) A statement that the transaction advertised is a lease;
(2) The total amount of periodic payments necessary to acquire ownership or a statement that the consumer has the option to purchase the property and at what time;
(3) That the consumer acquires no ownership rights if either the property is not leased for the term required for ownership to transfer or the terms of purchase are not otherwise satisfied.

If an advertisement for a terminable bailment or lease defined as a sale in subsection (b) above refers to the right to acquire ownership, the advertisement must clearly and conspicuously state whether or not the consumer may terminate the lease at any time without penalty and that the consumer acquires no ownership rights if either the property is not leased for the term required for ownership to transfer or the terms of purchase are not otherwise satisfied.

No one shall advertise in connection with any terminable bailment or lease defined as a sale in subsection (b) above the ownership option as a means of deceiving any lessee into believing that he is purchasing the item of personal property. (1971, c. 796, s. 1; 1979, c. 706, s. 1; 1981, c. 970, s. 2; 1983, c. 686, ss. 2, 3; 1987, c. 282, s. 5; 1991, c. 602, s. 1.)

CASE NOTES

Applied in In re Frady, 141 Bankr. 600 (Bankr. W.D.N.C. 1991).

§ 25A-5. "Services" defined.

CASE NOTES

Applied in Westminster Co. v. Union Mut. Stock Life Ins. Co. of Am., 95 N.C. App. 117, 381 S.E.2d 857 (1989).

§ 25A-7. "Cash price" defined.

CASE NOTES

Applied in In re Frady, 141 Bankr. 600 (Bankr. W.D.N.C. 1991).

§ 25A-14. Finance charge rates and service charge for revolving charge account contracts.

(a) The finance-charge rate and either the annual charge or the monthly service charge for a consumer credit sale made under a revolving charge account contract may not exceed the rates and charge provided for revolving credit by G.S. 24-11.

(b) In the event the revolving charge account contract is secured in whole or in part by a security interest in real property, then the finance-charge rate shall not exceed the rate set out in G.S. 25A-15(d).

(c) No default or deferral charge shall be imposed by the seller in connection with a revolving charge-account contract, except as specifically provided for in G.S. 24-11(d1). (1971, c. 796, s. 1; 1983, c. 126, s. 7; 1991, c. 506, s. 7.)

§ 25A-15. Finance charge rates for consumer credit installment sale contracts.

Legal Periodicals. — For note, "Civil Procedure — A Definition of 'Class' Under North Carolina Rule 23 — Crow v. Citicorp Acceptance Co.," see 23 Wake Forest L. Rev. 491 (1988).

§ 25A-17. Additional charges for insurance.

(a) As to revolving charge account contracts defined in G.S. 25A-11, in addition to the finance charges permitted in G.S. 24-11(a), a seller in a consumer credit sale may contract for and receive additional charges or premiums (i) for insurance written in connection with any consumer credit sale, against loss of or damage to property securing the debt pursuant to G.S. 25A-23, provided a clear, conspicuous and specific statement in writing is furnished by the seller to the buyer setting forth the cost of the insurance if obtained from or through the seller and stating that the buyer may choose the insurer through which the insurance is obtained; (ii) for credit life, credit accident and health, or credit unemployment insurance, written in connection with any consumer credit sale, provided the insurance coverage is not required by the seller and this fact is clearly disclosed to the buyer, and any buyer desiring such insurance coverage gives affirmative indication of such desire after disclosure of the cost of such insurance.

(b) As to revolving charge account contracts defined in G.S. 25A-11, insurance that is required by a seller and is not an additional charge permitted by subsection (a) of this section, shall be included in the finance charge as computed according to G.S. 24-11(a).

(c) As to consumer credit installment sale contracts defined in G.S. 25A-12, in addition to the finance charges permitted in G.S. 25A-15, a seller in a consumer credit sale may contract for and receive additional charges or premiums (i) for insurance written in connection with any consumer credit sale, for loss of or damage to property or against liability arising out of the ownership or use of property, provided a clear, conspicuous and specific statement in writing is furnished by the seller to the buyer setting forth the cost of the insurance if obtained from or through the seller and stating that the buyer may choose the person through which the insurance is to be obtained; (ii) for credit life, credit accident and health, or credit unemployment insurance, written in connection with any consumer credit sale, provided the insurance coverage is not required by the seller and this fact is clearly and conspicuously disclosed in writing to the buyer; and any buyer desiring such insurance coverage gives specific dated and separately signed affirmative written indication of such desire after receiving written disclosure to him of the cost of such insurance. (1971, c. 796, s. 1; 1993, c. 226, s. 15.)

§ 25A-18. Confession of judgment.

CASE NOTES

Cited in Burton v. Blanton, 107 N.C. App. 615, 421 S.E.2d 381 (1992).

§ 25A-23. Collateral taken by the seller.

CASE NOTES

Cited in Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

§ 25A-27. Application of payments.

(a) Where a seller in a consumer credit sale makes a subsequent sale to a buyer and takes a security interest pursuant to G.S. 25A-23 in goods previously purchased by the buyer from the seller, the seller shall make application of payments received, for the purpose of determining the amount of the debt secured by the various security interests, as follows:

(1) The entire amount of all payments made prior to such subsequent purchase shall be deemed to have been applied to the previous purchases, and

(2) Unless otherwise designated by the buyer, the amount of down payment on such subsequent purchase shall be applied to the subsequent purchase, and

(3) All subsequent payments shall be applied first to finance charges and then to principal. The application of payments to principal shall be applied to the various purchases on the basis that the first sums paid in shall be deemed applied to the oldest purchase or obligation assumed to satisfy the original debt secured by the purchase money security interest until payment is received in full and other payments shall be applied accordingly to all other purchases in the order that each obligation is assumed. At the time any original debt would have been satisfied by subsequent payments, the purchase money security interest in said purchase shall be extinguished.

(b) Where a seller and a buyer agree to consolidate two or more consumer credit installment sale contracts pursuant to G.S. 25A-31, the seller shall apply payments received, for the purpose of determining the amount of the debt secured by the various security interests, as follows:

(1) The entire amount of all payments received prior to the consolidation shall be applied to the respective contracts under which the payments were made, and

(2) All subsequent payments shall be applied first to finance charges and then to principal. The application of payments to principal shall be applied to the various purchases on the basis that the first sums paid in shall be deemed applied to the oldest purchase or obligation assumed to satisfy the original debt secured by the purchase money security

interest until payment is received in full and other payments shall be applied accordingly to all other purchases in the order that each obligation is assumed. At the time any original debt would have been satisfied by subsequent payments, the purchase money security interest in said purchase shall be extinguished.

(c) For payments received by a seller on or after October 1, 1988, but before October 1, 1993, a seller may elect to apply the provisions of this section as the section read October 1, 1993, or as the section read September 30, 1993. A seller made this election when the seller determined, and disclosed to the buyer, how payments received on a consumer credit sale would be applied: either on a proportional basis or on a "first in - first out" basis with the payments applied first to finance charges and then to principal in the order that each obligation is assumed.

(d) The exclusive remedy for failure of a seller to apply payments of a buyer as required by subdivision (a)(3) or (b)(2) of this section during the period October 1, 1993, through October 1, 1996, is an order that the seller apply the payments as required by those provisions. (1971, c. 796, s. 1; 1993, c. 370, s. 2; 1993 (Reg. Sess., 1994), c. 745, s. 38.3(a).)

Editor's Note. — Session Laws 1993 (Reg. Sess., 1994), c. 745, which amended this section, in s. 38.3(b) provides: "G.S. 25A-27(c), as enacted by this section, does not apply to pending actions"

CASE NOTES

Compliance Required. — Revolving chart account requiring that finance charges for newly purchased goods be satisfied before payments would be applied to previously purchased items expanded the existing security interest in prior purchases to secure not only their own purchase price but also the payment of finance charges on items bought later was an agreement that created a security interest in previously purchased property, and thereby required compliance with the apportionment provisions of this section. Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

Cited in In re Sherman, 126 Bankr. 684 (Bankr. E.D.N.C. 1987).

§ 25A-28. Form of consumer credit installment sale contract.

Legal Periodicals. — For survey of North Carolina construction law, with particular reference to unfair or deceptive acts or practices, see 21 Wake Forest L. Rev. 633 (1986).

§ 25A-32.1. Unearned finance charge credits on prepayment of loans secured by real property and mobile home loans.

(a) Notwithstanding any statutory or contractual provision to the contrary, in a consumer credit installment sale contract with an amount financed of five thousand dollars ($5000.00) or more secured by real estate or by a residential manufactured home as defined in G.S. 143-145(7), any buyer may satisfy the debt in full at any time before maturity, and in so satisfying the debt, shall be credited with all unearned finance charges as computed on the simple interest or actuarial method.

(b) If a seller obtains a judgment on a debt arising out of a consumer credit installment sale described in subsection (a) of this section, or if the seller forecloses or repossesses the collateral securing the debt, the seller shall credit the buyer with all unearned finance charges as computed on the simple interest or actuarial method as if the payment in full had been made on the date the judgment was obtained or 15 days after the foreclosure or repossession occurred, whichever is earlier. If the seller obtains a judgment and repossesses the collateral, the seller shall credit the buyer with all unearned finance charges as if payment in full had been made on the date of the judgment or 15 days after the repossession, whichever occurs earlier. (1991, c. 602, s. 2.)

Editor's Note. — Session Laws 1991, c. 602, s. 2, made this section effective July 1, 1991, and applicable to contracts made on or after that date.

§ 25A-37. Referral sales.

CASE NOTES

Referral Sale. — In essence, a referral sale is a transaction in which a person is induced to purchase goods or services upon the representation that the purchaser can reduce or recover the purchase price or earn a commission by referring other prospective buyers to the seller for similar purchases. Chapel Hill Spa Health Club, Inc. v. Goodman, 90 N.C. App. 198, 368 S.E.2d 60 (1988).

Referral Sales Condemned. — In recognition of the vast potential for deception and exploitation of the public inherent in referral sales and in furtherance of the vital state interest in protecting citizens from fraud, our legislature, by enacting this section, has condemned all referral sales contracts, declaring them both unlawful and unenforceable. Chapel Hill Spa Health Club, Inc. v. Goodman, 90 N.C. App. 198, 368 S.E.2d 60 (1988).

Fact that contingency in referral contract related to price of renewal rather than original membership was of little significance, since in either circumstance the promise of something for nothing would serve as the incentive to make a purchase. Chapel Hill Spa Health Club, Inc. v. Goodman, 90 N.C. App. 198, 368 S.E.2d 60 (1988).

Where spa represented to purchaser, in effect, that if she purchased an initial membership, she could then obtain an additional year or years of membership free by referring an adequate number of prospects to the spa, this transaction clearly constituted a sale of services with other consideration to the purchaser that is contingent upon the procurement of prospective customers provided by the purchaser. Thus, the contract between purchaser and the spa constituted a referral sale, in violation of this section, and was void and unenforceable. Chapel Hill Spa Health Club, Inc. v. Goodman, 90 N.C. App. 198, 368 S.E.2d 60 (1988).

§ 25A-39. Buyer's right to cancel.

Legal Periodicals. — For survey of North Carolina construction law, with particular reference to unfair or deceptive acts or practices, see 21 Wake Forest L. Rev. 633 (1986).

§ 25A-40. Form of agreement or offer; statement of buyer's rights.

Legal Periodicals. — For survey of North Carolina construction law, with particular reference to unfair or deceptive acts or practices, see 21 Wake Forest L. Rev. 633 (1986).

§ 25A-43. Unconscionability.

CASE NOTES

Stated in Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

§ 25A-44. Remedies and penalties.

CASE NOTES

Availability of Remedies. — In order to create a security interest in previously purchased property, the seller must provide for apportioning payments in the charge account contract. The failure to do so means that no security interest comes into existence and the remedies for a violation of this Act contained in this section do not apply. Sears, Roebuck & Co. v. Vandeusen, 155 Bankr. 358 (E.D.N.C. 1993).

Chapter 25C.

Sales of Artwork.

Article 2.

Sale of Prints.

Sec.
25C-10. Definitions.

ARTICLE 2.

Sale of Prints.

§ 25C-10. Definitions.

As used in this Article, the term:

(1) "Artist" means any person who created or who conceived of and approved:
  a. The master image of a work of art for a print, including but not limited to a photograph or a negative; or
  b. The master image of a work of art which served as the model for a print.

(2) "Art dealer" means a person:
  a. Who is in the business of dealing in prints to which this Article applies; or
  b. Who holds himself out as having knowledge or skills particular to prints to which this Article applies; or
  c. Who employs an agent or other intermediary who holds himself out as having knowledge or skills particular to prints to which this Article applies; or
  d. Who is a professional auctioneer who sells prints to which this Article applies, at auctions.

(3) "Fine print" means a printed image on paper or any other suitable substance which is based on an artist's master image and has been taken off a plate by printing, stamping, casting, or any other process commonly used in the graphic arts, and includes but is not limited to engraving, etching, woodcut, lithograph, or serigraph, or a print developed or created from a negative when such negative is itself an original work of art.

(4) "Person" means an individual, partnership, corporation, association, joint venture, or any other legal or commercial entity.

(5) "Plate" means a plate, stone, block, or other material used to create a fine print or from which a fine print is taken.

(6) "Print" means a fine print or reproduction as defined in this Article.

(7) "Photograph" means the image produced upon a photosensitive surface by the chemical action of light.

(8) "Negative" means any negative image, photographic plate, slide, or other material created by the artist and used for the purpose of creating the print.

(9) "Reproduction" means a copy of a fine print or other work of art made by a commercial mechanical process which does

not require the use of an original plate or an original negative.

(10) "Signed print" means a finished fine print autographed by the artist and not by mechanical means of reproduction, whether or not it was signed or unsigned in the plate.

(11) "Work of art" means an original art work that is:

a. A visual rendition, including a painting, drawing, sculpture, mosaic, or photograph;
b. A work of calligraphy;
c. A work of graphic art, including but not limited to a fine print;
d. A craft work in materials, including clay, textile, fiber, wood, metal, plastic, or glass; or
e. A work in mixed media, including a collage or a work consisting of any combination of works included in this subdivision. (1989, c. 464, s. 1; 1997-456, s. 27.)

Editor's Note. — The subdivisions of this section were renumbered pursuant to Session Laws 1997-456, s. 27, which authorized the Revisor of Statutes to renumber or reletter sections and parts of sections having a number or letter designation that is incompatible with the General Assembly's computer database.

Chapter 26.

Suretyship.

§ 26-3.1. Surety's recovery on obligation paid; no assignment necessary.

CASE NOTES

Sureties on bonds issued by principal cannot sue principal before paying all or part of the penal amount of the bonds. Harshaw v. Mustafa, 321 N.C. 288, 362 S.E.2d 541 (1987).

Time of Suit. — This section allows a surety to sue a principal on the original instrument or for reimbursement on the surety agreement. After three years, a suit on the latter theory would be barred by § 1-52. Where surety elects to sue on the underlying note under seal, he has the same rights the bank had on the original note. Thus, the 10-year statute of limitations, § 1-47, would apply. Adams v. Bass, 88 N.C. App. 599, 364 S.E.2d 194 (1988), cert. denied, 326 N.C. 363, 389 S.E.2d 810 (1990).

§ 26-5. Contribution among sureties.

CASE NOTES

III. Contribution Enforced.
  A. In General.

III. CONTRIBUTION ENFORCED.

A. In General.

Statute of Limitations. —

While the right to contribution among co-indemnitors or sureties has common law origin, since 1807 it has been a statutory right under the provisions of this section; accordingly, the applicable statute in this case provided that an action upon a liability created by statute must be brought within three years. Finch v. Barnes, 102 N.C. App. 733, 403 S.E.2d 552, rev'd on other grounds sub nom. State v. Case, 330 N.C. 192, 410 S.E.2d 57 (1991).

§ 26-7. Surety, indorser, or guarantor may notify creditor to take action.

CASE NOTES

I. General Consideration.

I. GENERAL CONSIDERATION.

Finding that language in guarantees served only to identify the guaranty as guaranty of payment and was not intended to waive this section comported with the rules of construction and the case law and would be upheld. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

In the parties' guaranty agreement, defendant promised not only to be liable for the entire balance of the note when it became due and payable upon a default, but also to make payment of any delinquent full installment, including delinquent interest 30 days after he had been given written notice of the default. Thus defendant's written promise to pay each individual installment upon default created an obligation covered by subsection (a) of this section. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

To be relevant on issue of implied waiver, evidence must show that defendant acted in manner which induced plaintiff to believe defendant intended to waive provisions of this section. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Duty to mitigate arises only in tort actions and breach of contract actions. Defendant's rights and remedies are statutorily mandated by this section through § 26-9. These statutes do not require defendant, as guarantor, to mitigate the damages he suffered because of plaintiff's failure to comply with this section. Therefore, the court declined to expand the scope of the duty to mitigate. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Evidence Held Sufficient. — Where note installment payment became due and payable on 1 January 1982, plaintiff notified defendant of the payment's delinquency on 19 January 1982, and defendant informed plaintiff on 25 January 1982 that he was exercising his rights under this section through § 26-9, the trial court's findings and conclusion, holding that defendant properly invoked subsection (a), were based on sufficient evidence. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Under this statute, plaintiff's refusal to move against either farm or the farm's collateral to collect the balance of the note due released defendant, as guarantor, only to the extent he was prejudiced. If the solvency of the farm and the value of its collateral were equivalent to the same values existing when note became due, when defendant gave plaintiff this section's notice, defendant would not have been prejudiced by plaintiff's failure to act and would have continued to be liable for the entire amount of the note he originally guaranteed. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Applied in Borg-Warner Acceptance Corp. v. Johnston, 97 N.C. App. 575, 389 S.E.2d 429 (1990).

§ 26-9. Effect of failure of creditor to take action.

CASE NOTES

Duty to mitigate arises only in tort actions and breach of contract actions. Defendant's rights and remedies are statutorily mandated by § 26-7 through this section. These statutes do not require defendant, as guarantor, to mitigate the damages he suffered because of plaintiff's failure to comply with § 26-7. Therefore, the court declined to expand the scope of the duty to mitigate. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Evidence Held Sufficient. — Where note installation payment became due and payable on 1 January 1982, plaintiff notified defendant of the payment's delinquency on 19 January 1982, and defendant informed plaintiff on 25 January 1982 that he was exercising his rights under § 26-7 through this section, the trial court's findings and conclusion, holding that defendant properly invoked subsection (a), were based on sufficient evidence. Federal Land Bank v. Lieben, 89 N.C. App. 395, 366 S.E.2d 592, aff'd, 323 N.C. 471, 373 S.E.2d 439 (1988).

Cited in Community Bank & Trust Co. v. Copses, 953 F.2d 133 (4th Cir. 1991).

§ 26-12. Joinder of debtor by surety.

CASE NOTES

Defendant guarantors could not avail themselves of the rights and privileges afforded by this section where the principal filed bankruptcy and was subject to the exclusive jurisdiction of the United States District Court for the Western District of North Carolina; the statute expressly states that the principal must be joined as a party and to do so requires the surety to show that the state courts have jurisdiction over the principal. Borg-Warner Acceptance Corp. v. Johnston, 97 N.C. App. 575, 389 S.E.2d 429 (1990), cert. denied, 333 N.C. 254, 424 S.E.2d 918 (1993).

Quoted in Poughkeepsie Sav. Bank v. Harris, 833 F. Supp. 551 (W.D.N.C. 1993).

Cited in Resolution Trust Corp. v. Southwest Dev. Co., 837 F. Supp. 122 (E.D.N.C. 1992).

STATE OF NORTH CAROLINA

Department of Justice

Raleigh, North Carolina

December 1, 1997

I, Michael F. Easley, Attorney General of North Carolina, do hereby certify that the foregoing 1997 Cumulative Supplement to the General Statutes of North Carolina was prepared and published by Michie under the supervision of the Department of Justice of the State of North Carolina.

Michael F. Easley

Attorney General of North Carolina

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STATE OF NORTH CAROLINA

DEPARTMENT OF JUSTICE

Raleigh, North Carolina

December 1, 1997

I, Michael F. Easley, Attorney General of North Carolina, do hereby certify that the foregoing 1997 Cumulative Supplement to the General Statutes of North Carolina was prepared and published by Michie under the supervision of the Department of Justice of the State of North Carolina.

MICHAEL F. EASLEY

Attorney General of North Carolina